

## **PART II**



## PART II

### ACCOUNTS AND OPERATIONS OF THE CENTRAL BANK OF SRI LANKA

|  | <i>Page</i> |
|--|-------------|
| 1. Accounts and Finance                            | 01          |
| 2. Bank Supervision                                | 38          |
| 3. Centre for Banking Studies                      | 41          |
| 4. Communications                                  | 41          |
| Library and Information Centre                     |             |
| 5. Currency  | 43          |
| 6. Domestic Operations                             | 44          |
| 7. Economic Research                               | 48          |
| 8. Employees' Provident Fund                       | 50          |
| 9. Exchange Control                                | 53          |
| 10. Financial Intelligence Unit                    | 54          |
| 11. Financial System Stability                     | 55          |
| 12. Governor's Secretariat                         | 56          |
| 13. Human Resources Management                     | 57          |
| 14. Information Technology                         | 63          |
| 15. International Operations                       | 64          |
| 16. Management Audit                               | 66          |
| 17. Payments and Settlements                       | 67          |
| 18. Policy Review and Monitoring                   | 70          |
| 19. Premises                                       | 72          |
| 20. Provincial Offices Monitoring                  | 72          |
| 21. Public Debt                                    | 73          |
| 22. Regional Development                           | 76          |
| 23. Secretariat                                    | 80          |
| 24. Security Services                              | 80          |
| 25. Statistics and Field Surveys                   | 81          |
| 26. Supervision of Non-Bank Financial Institutions | 82          |
| 27. Welfare  | 87          |



## 1. ACCOUNTS AND FINANCE

### CENTRAL BANK OF SRI LANKA

#### Report of the Monetary Board Advisory Audit Committee

The Audit Committee (AC) appointed by the Monetary Board consists of three Members: Mrs. Mano Ramanathan, the appointed member of the Monetary Board (Chairperson of AC), Mr. M. R. Mihular (Partner KPMG Ford, Rhodes Thorton & Co), and Mrs. A. M. J. Patrick (Partner SJMS Associates). Dr. P.W.R.B.A.U Herat (upto March 2009) and Mr. P.D.J.Fernando(from April 2009), Assistant Governors, functioned as the Secretary to the Committee during 2009.

During the financial year 2009 the AC met on 9 occasions and carried out the following tasks:

- Reviewed the draft final accounts of Central Bank of Sri Lanka (CBSL) for 2008 prior to signing off by auditors & agreed on certain disclosures.
- Followed up issues highlighted by the External Auditors in their Management Letter (ML) on the 2008 accounts of the Central Bank.
- The following recommendations were made by the AC in relation to ML issues raised:
  - o Independent verification of external reports by Director, Management Audit.
  - o Any future concessionary loans be fair valued as per IFRS.
  - o Hostel Block, Rajagiriya be recorded under Property, Plant & Equipment.
- Approved the Audit Plan 2010 of the Management Audit Department subject to scope limitations.
- Agreed with the Audit Plan of External Auditors -2009.
- Held discussions with the IMF Safeguards Assessment (SA) team during their visit to Sri Lanka in April 2009 and agreed on the following recommendations of the SA team.
  - o Revise the Terms of Reference (TOR) of the AC incorporating the requirements of qualifications of the members, conditions of renewal of appointment to the Committee, termination, criteria for the term of appointment and oversight of the risk management framework.
  - o A quality assessment review to be done on the Management Audit Department in line with the IIA Standards.
  - o A training plan for specialization in areas such as IT systems audit to be done by Dec. 2009.
  - o An action plan to be put in place by September 2009, to implement the 2011 Audit Plan under a risk based methodology.
- Reviewed Impairment Assessment framework of the CBSL's balance sheet.
- Reviewed relevant projections by the Economic Research Department and agreed on the discount rate to be used for Actuarial Valuations and staff loan amortization calculations.
- Made recommendations for the phasing out of the pre audit work.
- Reviewed the Capacity & Quality Development of Management Audit Function & made recommendations to introduce IS Audits for CBSL.
- Recommended the compilation of a comprehensive risk assessment document, identifying operational & transaction level risks and their mitigation procedures.
- Recommendations were made on the progress report of Director Management Audit.

### Management Statement

#### Accountability and the Financial Performance of the Central Bank of Sri Lanka in relation to the Objectives

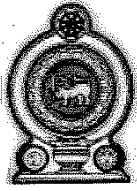
The CBSL was established as the authority responsible for the administration, supervision and regulation of the monetary, financial and payment systems of Sri Lanka under the Monetary Law Act. In accordance with this Act, the CBSL is charged with the responsibility of securing the core objectives of economic and price stability and financial system stability.

The basis of accountability for the CBSL and the success of its operations therefore would be the effectiveness of its policies and operations leading towards the achievement of its core objectives and not necessarily its profitability *per se*. These statutory objectives are the fundamental features that distinguish the CBSL from any other entity, private or public. Accordingly, a profitability related approach, if adopted by the CBSL, could result in the Bank pursuing profits while compromising its core objectives, since it has the unique ability to create its own profits through its monetary policy activities, which could influence interest rates and exchange rates.

It therefore follows that the CBSL's objectives of economic and price stability and financial system stability need to be distinguished and detached from the pure profitability objective which should essentially be incidental or academic only.

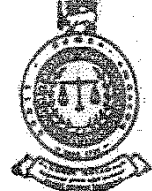
In this background, the CBSL's financial statements record gains and/or deficits in the implementation of its monetary policy operations, exchange rate management, issuing of currency, etc. at the values as realized and hence, the financial performance as reported in these statements needs to be interpreted and understood in that context.

The Bank is subject to an external audit by the Auditor General under the Monetary Law Act sections 42 & 43. The Auditor General in turn has obtained the services of a firm of Chartered Accountants M/S Ernst & Young to carry out an audit under International Standards of Auditing to ensure compliance with the International Financial Reporting Standards.



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எனது இல  
My No.

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கணக்காய்வாளர் தலைமை அபிப்பதி திணைக்களம்  
**AUDITOR GENERAL'S DEPARTMENT**



ඔබේ අංකය  
உமது இல  
Your No.

දිනය  
திகதி  
Date

EF/J/CB/FA/2010

18<sup>th</sup> March 2010

**REPORT OF THE AUDITOR GENERAL**

The audit of the accompanying financial statements of the Central Bank of Sri Lanka (CBSL), which comprise the Statement of Financial Position as at 31 December 2009, and the Income Statement, Statement of Movements in Equity and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory notes thereto (Nos. 1 to 41) to the financial statements was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13 of the Finance Act, No.38 of 1971 and Section 42(2) of the Monetary Law Act, (Chapter 422). The audit of the financial statements of the CBSL with regard to the compliance of International Financial Reporting Standards had been carried out by a firm of Chartered Accountants in public practice appointed by me.

**Responsibility of the Management for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error, selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

**Scope of Audit and Basis of Opinion**

My responsibility is to express an opinion on these financial statements based on my audit. The audit was carried out in accordance with International Standards on Auditing. Those Standards require that the auditor comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatements. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. I have obtained sufficient information and explanations which to the best of my knowledge and belief were necessary for the purpose of my audit. I therefore believe that my audit provides a reasonable basis for my opinion. Sub-sections (3) and (4) of the Section 13 of the Finance Act, No.38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the Audit.

**Opinion**

I am of opinion, that the financial statements of the CBSL present fairly, in all material respects the financial position of the Bank as at 31 December 2009 and the financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

**Report to Parliament**

My report to Parliament in pursuance of provisions in Article 154(6) of the Constitution will be tabled in due course.

S. Swarnajothi  
Auditor General

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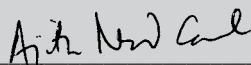
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**CENTRAL BANK OF SRI LANKA****Statement of Financial Position****As at 31 December 2009**

|  | Note   | 2009<br>Rs. '000   | 2008<br>Rs. '000   |
|--|--------|--------------------|--------------------|
| <b>Assets</b>  |        |                    |                    |
| <b>Foreign Currency Financial Assets</b>               |        |                    |                    |
| Cash & Cash Equivalents                                |        | 147,871,157        | 167,338,807        |
| Financial Assets:                                      |        |                    |                    |
| -Securities at Fair value through Profit or Loss       | 5      | 56,275,323         | 50,381,845         |
| -Available for Sale Investments                        | 5      | 315,342,452        | 41,733,314         |
| Other Foreign Receivables                              |        | 2,429,319          | 1,427,899          |
| IMF Related Assets                                     | 6      | 76,509,781         | 72,399,875         |
| <b>Total Foreign Currency Financial Assets</b>         |        | <b>598,428,032</b> | <b>333,281,740</b> |
| <b>Local Currency Financial Assets</b>                 |        |                    |                    |
| Investment Portfolio - Sri Lanka Government Securities |        | 43,450,557         | 159,771,674        |
| Advances to Government                                 | 7      | 73,880,500         | 76,307,700         |
| Loans to Other Institutions                            | 8      | 1,136,596          | 1,577,301          |
| Other Local Receivables                                |        | 595,444            | 659,770            |
| Investments in Financial and Other Institutions        | 9      | 43,855             | 50,729             |
| Other Assets   |        | 1,497,973          | 1,364,690          |
| <b>Total Local Currency Financial Assets</b>           |        | <b>120,604,925</b> | <b>239,731,864</b> |
| <b>Total Financial Assets</b>                          |        | <b>719,032,957</b> | <b>573,013,604</b> |
| <b>Foreign Currency Non - Financial Assets</b>         |        |                    |                    |
| Securities Denominated in Gold                         |        | 84,834,269         | 10,427,432         |
| <b>Local Currency Non - Financial Assets</b>           |        |                    |                    |
| Inventories  | 10     | 2,157,200          | 1,961,687          |
| Sundry Assets  |        | 4,092,428          | 2,405,922          |
| Property, Plant and Equipment                          | 11     | 9,342,947          | 9,242,988          |
| Intangible Assets                                      | 12     | 16,383             | 15,717             |
| Pension and Other Post Employment Benefit Plans        | 36     | 293,476            | -                  |
| <b>Total Non- Financial Assets</b>                     |        | <b>100,736,703</b> | <b>24,053,746</b>  |
| <b>Total Assets</b>                                    |        | <b>819,769,660</b> | <b>597,067,350</b> |
| <b>Liabilities and Equity</b>                          |        |                    |                    |
| <b>Foreign Currency Financial Liabilities</b>          |        |                    |                    |
| Amounts Payable to Banks and Financial Institutions    | 13     | 18,068,841         | 336,091            |
| Amounts Payable to Asian Clearing Union                | 14     | 29,836,531         | 91,354,909         |
| IMF Related Liabilities                                | 15     | 218,171,021        | 95,133,658         |
| Other Foreign Payables                                 | 16     | 5,008,035          | 1,517,077          |
| <b>Total Foreign Currency Financial Liabilities</b>    |        | <b>271,084,428</b> | <b>188,341,735</b> |
| <b>Local Currency Financial Liabilities</b>            |        |                    |                    |
| Deposits by Banks and Financial Institutions           | 17     | 86,085,866         | 82,311,214         |
| Balances with Government and Government Entities       | 18 (a) | 2,347,709          | 1,245,624          |
| Securities Sold Under Agreements to Repurchase         | 18 (b) | 84,022,645         | 13,743,000         |
| Balances with Employee Benefit Plans                   | 19     | 1,050,255          | 1,155,061          |
| Other Payables   |        | 25,981,654         | 1,664,352          |
| <b>Total Local Currency Financial Liabilities</b>      |        | <b>199,488,129</b> | <b>100,119,251</b> |
| <b>Total Financial Liabilities</b>                     |        | <b>470,572,557</b> | <b>288,460,986</b> |
| <b>Other Liabilities</b>                               |        |                    |                    |
| Currency in Circulation                                | 20     | 217,429,835        | 186,098,914        |
| Deferred Grants  | 21     | 567                | -                  |
| Pension and Other Post Employment Benefit Plans        | 36     | -                  | 1,026,698          |
| Miscellaneous Liabilities and Accruals                 |        | 66,895             | 531,960            |
| <b>Total Other Liabilities</b>                         |        | <b>217,497,297</b> | <b>187,657,572</b> |
| <b>Total Liabilities</b>                               |        | <b>688,069,854</b> | <b>476,118,558</b> |
| <b>Equity</b>  |        |                    |                    |
| Capital Funds  | 22     | 25,000,000         | 25,000,000         |
| Reserves   |        | 106,699,806        | 95,948,792         |
| <b>Total Equity</b>                                    |        | <b>131,699,806</b> | <b>120,948,792</b> |
| <b>Total Liabilities and Equity</b>                    |        | <b>819,769,660</b> | <b>597,067,350</b> |

The Governor and the Chief Accountant of the Central Bank of Sri Lanka authorised these financial statements for issue on 08th March 2010, for and on behalf of the Monetary Board.



Ajith Nivard Cabraal – Governor



K. M. A. N. Daulagala – Chief Accountant

The Accounting Policies and Notes on pages (Part II - 7) through (Part II - 37) form an integral part of the Financial Statements.

**CENTRAL BANK OF SRI LANKA**  
**Income Statement**  
**Period ended 31 December 2009**

|   | Note | 2009<br>Rs. '000         | 2008<br>Rs. '000          |
|---|------|--------------------------|---------------------------|
| <b>Operating Income:</b>  |      |                          |                           |
| <b>Income from Foreign Currency Financial Assets</b>            |      |                          |                           |
| Interest Income   | 24   | 4,595,856                | 11,129,190                |
| Gain /(Loss) from Unrealized Price Revaluations                 |      | (4,177,107)              | 2,211,883                 |
| Gain /(Loss) Realized from Price Changes                        |      | <u>6,689,834</u>         | <u>6,648,280</u>          |
| <b>Total Income from Foreign Currency Financial Assets</b>      |      | <b>7,108,583</b>         | 19,989,353                |
| <b>Expenses on Foreign Currency Financial Liabilities</b>       |      |                          |                           |
| Interest Expense  | 25   | <u>(1,832,436)</u>       | <u>(1,301,552)</u>        |
| <b>Total Expenses on Foreign Currency Financial Liabilities</b> |      | <b>(1,832,436)</b>       | (1,301,552)               |
| Net Foreign Exchange Revaluation Gain /(Loss)                   |      | <u>8,842,035</u>         | <u>(22,810,925)</u>       |
| <b>Foreign Currency Investment Income /(Loss)</b>               |      | <b>14,118,182</b>        | (4,123,124)               |
| <b>Income from Local Currency Financial Assets</b>              |      |                          |                           |
| Interest Income   | 24   | 28,111,337               | 7,043,031                 |
| Interest Expense  | 25   | <u>(2,534,820)</u>       | <u>(511,709)</u>          |
| <b>Total Income from Local Currency Financial Assets</b>        |      | <b>25,576,517</b>        | 6,531,322                 |
| Other Income  | 26   | <u>544,217</u>           | <u>454,250</u>            |
| <b>Total Net Operating Income /(Loss)</b>                       |      | <b>40,238,916</b>        | 2,862,448                 |
| <b>Operating Expenses:</b>                                      |      |                          |                           |
| Personnel Expenses :  | 27   |                          |                           |
| - Salaries & wages  |      | (2,128,264)              | (1,718,302)               |
| - Defined Contribution plan cost                                |      | (276,101)                | (215,066)                 |
| - Additional contribution to Post Employment Benefit Plans      |      | -                        | (1,333,944)               |
|   |      | <u>(2,404,365)</u>       | <u>(3,267,312)</u>        |
| Depreciation & Amortization                                     |      | (295,759)                | (302,977)                 |
| Cost of Inventory   |      | (1,350,463)              | (926,586)                 |
| Administration Expenses   | 28   | <u>(913,307)</u>         | <u>(1,472,257)</u>        |
| <b>Total Operating Expenses</b>                                 |      | <b>(4,963,894)</b>       | (5,969,132)               |
| <b>Profit /(Loss) Before Income Tax</b>                         |      | <u>35,275,022</u>        | <u>(3,106,684)</u>        |
| Income Tax  | 29   | <u>(1,636,373)</u>       | <u>(1,937,740)</u>        |
| <b>Net Profit /(Loss) for the Year</b>                          |      | <b><u>33,638,649</u></b> | <b><u>(5,044,424)</u></b> |



**CENTRAL BANK OF SRI LANKA**  
**Consolidated Statement of Comprehensive Income**  
**Period ended 31 December 2009**

|   | 2009<br>Rs. '000  | 2008<br>Rs. '000   |
|---|-------------------|--------------------|
| Net Profit /(Loss) for the Year                               | 33,638,649        | (5,044,424)        |
| Net Fair Value Gain / (Loss) on Available for Sale Securities | (2,887,636)       | 2,603,850          |
| Revaluation Gain  | -                 | -                  |
| Revaluation of Land and Building                              | -                 | -                  |
|   | <u>30,751,013</u> | <u>(2,440,574)</u> |

**Statement of Movements in Equity**  
**Period ended 31 December 2009**

|   | Contributed<br>Capital<br>Rs. '000 | Reserves<br>Appropriated<br>As Capital<br>Rs. '000 | Revaluation<br>Reserve<br>Rs. '000 | Other<br>Reserves<br>(Note 22)<br>Rs. '000 | Accumulated<br>Profits<br>Rs. '000 | Total<br>Rs. '000  |
|---|------------------------------------|--|------------------------------------|--|------------------------------------|--------------------|
| <b>As at 01 January 2008</b>  | 15,000                             | -  | 2,706,067                          | 102,147,926                                | 26,520,374                         | 131,389,367        |
| Net Profit /(Loss)  | -                                  | -  | -                                  | -  | (5,044,424)                        | (5,044,424)        |
| Transfer to RTGS Sinking Fund   | -                                  | -  | -                                  | 63,294                                     | (63,294)                           | -                  |
| Transfer to General Reserve   | -                                  | -  | -                                  | 7,308,252                                  | (7,308,252)                        | -                  |
| Transfer to Market Valuation Reserve  | -                                  | -  | -                                  | 4,413,887                                  | (4,413,887)                        | -                  |
| Transfer of Net Foreign Exchange  |                                    |  |                                    |  |                                    |                    |
| Revaluation Gain  | -                                  | -  | -                                  | (22,810,925)                               | 22,810,925                         | -                  |
| Transfer to CBSL Specific Reserve   | -                                  | -  | -                                  | 150,377                                    | (150,377)                          | -                  |
| Transfer of Profit to Govt  | -                                  | -  | -                                  | -  | (8,000,000)                        | (8,000,000)        |
| Transfer of Funds from General<br>Reserve to Reserve Appropriated<br>as Capital | -                                  | 24,985,000   | -                                  | (24,985,000)                               | -                                  | -                  |
| Net Fair Value Gain / (Loss) on<br>Available for Sale Securities                | -                                  | -  | -                                  | 2,603,850                                  | -                                  | 2,603,850          |
| <b>As at 01 January 2009</b>  | <u>15,000</u>                      | <u>24,985,000</u>                                  | <u>2,706,067</u>                   | <u>68,891,661</u>                          | <u>24,351,065</u>                  | <u>120,948,793</u> |
| Net Profit /(Loss)  | -                                  | -  | -                                  | -  | 33,638,649                         | 33,638,649         |
| Transfer to RTGS Sinking Fund   | -                                  | -  | -                                  | 95,043                                     | (95,043)                           | -                  |
| Transfer to Market Valuation Reserve  | -                                  | -  | -                                  | 2,211,883                                  | (2,211,883)                        | -                  |
| Transfer of Net Foreign Exchange  |                                    |  |                                    |  |                                    |                    |
| Revaluation Gain /(Loss)  | -                                  | -  | -                                  | 8,842,035                                  | (8,842,035)                        | -                  |
| Transfer to CBSL Specific Reserve   | -                                  | -  | -                                  | 269,798                                    | (269,798)                          | -                  |
| Net Fair Value Gain / (Loss) on<br>Available for Sale Securities                | -                                  | -  | -                                  | (2,887,636)                                | -                                  | (2,887,636)        |
| Transfer of Profit in Advance<br>to Government                                  | -                                  | -  | -                                  | -  | (20,000,000)                       | (20,000,000)       |
| <b>As at 31 December 2009</b>   | <u>15,000</u>                      | <u>24,985,000</u>                                  | <u>2,706,067</u>                   | <u>77,422,784</u>                          | <u>26,570,955</u>                  | <u>131,699,806</u> |

**CENTRAL BANK OF SRI LANKA**  
**Statement of Cash Flows**  
**Period ended 31 December 2009**

|   | Note      | 2009<br>Rs. '000            | 2008<br>Rs. '000            |
|---|-----------|-----------------------------|-----------------------------|
| <b>Cash Flow from Operating Activities:</b>   |           |                             |                             |
| <b>Source:</b>  |           |                             |                             |
| Interest Received - Foreign Currency  |           | 3,620,945                   | 11,970,696                  |
| Interest Received - Local Currency - Others   |           | 452,164                     | 688,187                     |
| Liquidity Management, Trading & SWAP Income   |           | 6,992,342                   | 6,648,280                   |
| Realized Exchange Gain / (loss)   |           | 673,475                     | (269,850)                   |
| Fees, Commission & Other Income Received  |           | <u>468,899</u>              | <u>454,182</u>              |
|   |           | 12,207,825                  | 19,491,495                  |
| <b>Disbursements:</b>   |           |                             |                             |
| Interest Paid - Foreign Currency  |           | 1,963,574                   | 1,447,241                   |
| Interest Paid - Local Currency  |           | 2,156,462                   | 507,687                     |
| Payments to Employees   |           | 3,747,815                   | 3,608,251                   |
| Payments to Suppliers   |           | (21,256,640)                | 2,747,377                   |
| Income Tax Paid   |           | <u>1,857,983</u>            | <u>2,240,921</u>            |
|   |           | <u>(11,530,806)</u>         | <u>10,551,477</u>           |
| <b>Net Cash Flow from Operating Activities</b>  | <b>30</b> | <u><b>23,738,631</b></u>    | <u><b>8,940,018</b></u>     |
| <b>Cash Flows from Investing Activities:</b>  |           |                             |                             |
| <b>Source:</b>  |           |                             |                             |
| Net (Increase) / Decrease in Other Local Currency Financial Assets                                |           | (1,879,364)                 | (304,851)                   |
| Principal recoveries from the Loans and Advances to Other Institutions                            |           | 2,688,756                   | 252,307                     |
| Disposal / Redemption of Investments in Financial and Other Institutions                          |           | 6,874                       | (594)                       |
| Sale of Property, Plant and Equipment   |           | 1,367                       | -                           |
| Income on Investments in Financial and Other Institutions   |           | -                           | -                           |
| Net Increase in Securities Purchased under Agreement to Re-sell                                   |           | <u>70,279,645</u>           | <u>13,725,000</u>           |
|   |           | 71,097,278                  | 13,671,863                  |
| <b>Disbursements:</b>   |           |                             |                             |
| Net Increase / (Decrease) in Foreign Currency Securities  |           | 286,976,540                 | (86,444,960)                |
| Net Increase / (Decrease) in Other Foreign Currency Financial Assets                              |           | 1,496,343                   | (541,626)                   |
| Net Increase / (Decrease) in Other Foreign Currency Financial Liabilities                         |           | 40,717,160                  | (33,914,788)                |
| Net Increase / (Decrease) in Other Local Deposits & Payables                                      |           | 4,290                       | (4,861)                     |
| Purchase of Property, Plant and Equipment net of Grants   |           | 387,795                     | (2,269,492)                 |
| Net Increase/(Decrease) in Gold Inventory   |           | 75,691,109                  | 206,080                     |
| Loans & advances granted to other institutions  |           | <u>2,203,105</u>            | <u>-</u>                    |
|   |           | <u>407,476,342</u>          | <u>(122,969,647)</u>        |
| <b>Net Cash Flow from Investing Activities</b>  |           | <u><b>(336,379,064)</b></u> | <u><b>136,641,510</b></u>   |
| <b>Cash Flows from Financing Activities:</b>  |           |                             |                             |
| <b>Source:</b>  |           |                             |                             |
| Issue of Circulating Currency   |           | (218,514,268)               | 219,507,915                 |
| Withdrawal of Circulating Currency  |           | <u>249,845,187</u>          | <u>(206,772,722)</u>        |
| Net Issue of Circulating Currency   |           | 31,330,919                  | 12,735,193                  |
| <b>Less:</b>  |           |                             |                             |
| Net Issue / (Withdrawals) of Circulation Currency on Government Transactions                      | 31        | (147,556,788)               | 125,419,584                 |
| Net Issue / (Withdrawals) of Circulation Currency on Bank and Financial Institutions Transactions | 32        | <u>(4,149,819)</u>          | <u>8,741,810</u>            |
| Net Issue / (Withdrawals) of Circulating Currency   |           | <u>(151,706,607)</u>        | <u>134,161,394</u>          |
|   |           | 183,037,526                 | (121,426,201)               |
| <b>Disbursements:</b>   |           |                             |                             |
| Repayment of Foreign Currency Term Liabilities  |           | (121,365,370)               | 8,313,981                   |
| Payments to Other Funds   |           | -                           | -                           |
| Payments of Surplus to Government   |           | <u>20,000,000</u>           | <u>8,000,000</u>            |
|   |           | <u>(101,365,370)</u>        | <u>16,313,981</u>           |
| <b>Net Cash Flow from Financing Activities</b>  |           | <u><b>284,402,896</b></u>   | <u><b>(137,740,182)</b></u> |
| Net Increase in Cash and Cash Equivalents   |           | (28,237,537)                | 7,841,345                   |
| Exchange Rate Effect on Cash and Cash Equivalents   |           | 8,769,887                   | (554,517)                   |
| Cash and Cash Equivalent at the Beginning of the Year   |           | <u>167,338,807</u>          | <u>160,051,979</u>          |
| <b>Cash and Cash Equivalent at 31 December</b>  | <b>33</b> | <u><b>147,871,157</b></u>   | <u><b>167,338,807</b></u>   |

## Notes to be read as part of the Financial Statements

### Period ended 31 December 2009

#### 1. Reporting Entity and Statutory Base

The Central Bank of Sri Lanka (“Bank” or “CBSL”), is an institution established under the Monetary Law Act No 58 of 1949 of Sri Lanka as amended (“MLA”), as the authority responsible for the administration, supervision and regulation of monetary, financial and payment system of Sri Lanka. Central Bank of Sri Lanka is domiciled in the Democratic Socialist Republic of Sri Lanka and situated at No: 30, Janadhipathi Mawatha, Colombo 01.

These financial statements were authorised for issue by the Governor and Chief Accountant for and on behalf of the Monetary Board on 08th March 2010.

#### 2. Accounting Policies

##### 2.1 Basis of preparation

The financial statements are prepared on the historical cost basis, except for land & buildings and certain financial assets that have been measured at fair value as identified in specific accounting policies below.

##### Reporting Format

The Bank presents financial assets and financial liabilities, and their associated income and expense streams, by distinguishing between foreign currency and local currency activities. In the Statement of Financial Position, assets & liabilities are presented broadly in order of liquidity within such distinguished category. The Bank considers that this reporting approach provide appropriate reporting of the Bank’s activities which are more fully described in Note 4.

##### Statement of Compliance

These financial statements of the Central Bank of Sri Lanka for the period ended 31 December 2009 have been prepared in accordance with International Financial Reporting Standards (IFRS). The financial statements prepared in accordance with the Monetary Law Act (MLA) are audited by the Auditor General and gazetted as required by the law. Due to certain requirements in the IFRS, the classifications, and hence the amounts in the gazetted financial statements would be different from those in these financial statements.

##### Currency of Presentation

The Financial statements are presented in Sri Lanka Rupees (SLR) and all the values are rounded to nearest Rupees thousands, except when otherwise indicated.

##### 2.2 Significant Accounting Judgments and Estimates

In the process of applying the accounting policies, the Bank has made the following judgments apart from those involving

estimations, which have the most significant effect on the amounts recognized in the financial statements.

##### Impairment of Available for Sale Investments

The Bank determines that Available for Sale Investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment.

##### Pensions and Other Post Employment Benefit Plans

The cost of defined benefit plans is determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future compensation increases, mortality rates and future pension increases. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. Assumptions used are disclosed in Note 36.

##### 2.3 Changes in accounting policy and disclosures

The accounting policies adopted are consistent with those used in the previous financial year except that the bank has adopted the following standards, amendments and interpretations. With the exception of the Amendments to IAS 39 and IFRS 7 - Reclassification of Financial Assets (see below), the adoption of these standards, amendments and interpretations did not have any effect on the financial performance or position of the bank. They did, however, give rise to additional disclosures.

##### IAS 1 Presentation of financial statements

This standard requires an entity to present all owner changes in equity and all non-owner changes to be presented in either in one statement of comprehensive income or in two separate statements of income and comprehensive income. The revised standard also requires that the income tax effect of each component of comprehensive income be disclosed. In addition, it requires entities to present a comparative statement of financial position as at the beginning of the earliest comparative period when the entity has applied an accounting policy retrospectively, makes a retrospective restatement, or reclassifies items in the financial statements.

The bank has elected to present comprehensive income in two separate statements of income and comprehensive income. The bank has also provided a comparative statements of comprehensive income.

##### Amendments to IFRS 7 Financial Instruments: Disclosures - Improving Disclosures about Financial Instruments.

The amendments to IFRS 7 were issued in March 2009 to enhance fair value and liquidity disclosures.

With respect to fair value, the amendments require disclosure of a three-level fair value hierarchy, by class, for all financial

instruments recognised at fair value and specific disclosures related to the transfers between levels in the hierarchy and detailed disclosures related to level 3 of the fair value hierarchy. In addition, the amendments modify the required liquidity disclosures with respect to derivative transactions and assets used for liquidity management.

The following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3: techniques which use input which have a significant effect on the recorded fair value that are not based on observable market data.

The bank has adopted level one of the fair value hierarchy for all the classes of financial instruments and disclosures have been made by class in the financial statements.

### **IFRS 8 Operating Segments**

This standard requires disclosure of information about the Bank's operating segments and replaced the requirement to determine primary (business) and secondary (geographical) reporting segments of the Bank. The bank concluded that the operating segments determined in accordance with IFRS 8 are the same as the business segments previously identified under IAS 14.

### **Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures - Reclassification of Financial Assets**

The amendments allow Bank to reclassify certain financial assets out of held-for-trading if they are no longer held for the purpose of being sold or repurchased in the near term:

Financial assets that would be eligible for classification as loans and receivables (i.e., those assets which, apart from not being held with the intent of sale in the near term, have fixed or determinable payments, are not quoted in an active market and contain no features which could cause the holder not to recover substantially all of its initial investment except through credit deterioration) may be transferred from 'Held-for-trading' to 'Loans and receivables', if the Bank has the intention and the ability to hold them for the foreseeable future.

Financial assets that are not eligible for classification as loans and receivables, may be transferred from 'Held-for-trading' to 'Available-for-sale' or to 'Held-to-maturity', only in rare circumstances.

The bank has not made such reclassification of financial assets.

### **Improvements to IFRSs**

In May 2008 and April 2009 the IASB issued omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. The adoption of the following amendments did not have any material impact on the financial position or performance of the bank.

- IFRS 8 Operating Segment Information.
- IAS 1 Presentation of Financial Statements: Assets and liabilities classified as held for trading in accordance with IAS 39 Financial Instruments.
- IAS 7 Statement of Cash Flows: Explicitly states that only expenditure that results in recognising an asset can be classified as a cash flow from investing activities.
- IAS 36 Impairment of Assets.
- IAS 20 Accounting for Government Grants and Disclosures of Government Assistance.
- IAS 38 Intangible Assets.

### **2.4. Standards, interpretations and amendments to published standards that are not yet effective**

Certain new standards, amendments and interpretations to existing standards have been published that are applicable for the Bank's accounting periods beginning on or after 1 January 2009 or later periods but which the Bank has not early adopted, as follows:

IFRS 9, Financial Instruments (effective from 1 January 2013) – IFRS 9 specifies the new requirement for classifying & measuring financial assets, which replace the IAS 39 Financial Instruments: Recognition and Measurement.

## **3. Summary of Significant Accounting Policies**

### **3.1 Foreign Currency Conversions**

The Bank's functional and presentation currency is Sri Lanka Rupees (Rs). Transactions in foreign currencies are initially recorded in the functional currency ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the Statement of Financial Position date. All differences are taken to the Income Statement. For the purposes of retranslation the following Sri Lanka Rupee exchange rates for major currencies were used:

|                                | 2009<br>Rs. | 2008<br>Rs. |
|--------------------------------|-------------|-------------|
| 1 Australian Dollar            | 101.9909    | 78.0495     |
| 1 Canadian Dollar              | 109.2914    | 92.7604     |
| 1 Euro                         | 163.7184    | 159.4536    |
| 1 Japanese Yen                 | 1.2413      | 1.2524      |
| 1 Special Drawing Rights (SDR) | 178.6670    | 174.2660    |
| 1 Sterling Pound               | 181.7454    | 163.2777    |
| 1 United States Dollar         | 114.3844    | 113.1398    |

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using exchange rates at the dates of initial transactions.

### 3.2 Financial Assets and Liabilities

The Bank presents financial assets and liabilities, and the associated income and expense streams, by distinguishing between foreign currency and local currency activities. Foreign currency activities mainly arise from the Bank's foreign reserves management function. Local currency activities mainly reflect the assets and liabilities associated with monetary policy implementation, issuing currency and banking activities.

The separate reporting of these activities is considered to provide a better presentation of the Bank's financial position, financial performance and risk profile. The Bank considers that the combined reporting of foreign and local currency activities would weaken the informational value of the financial statements.

All financial assets are initially recognised at cost, being the fair value of the consideration given and including acquisition charges associated with the investment. Subsequent measurement bases after initial recognition are described below. All regular way purchases and sales of financial assets are recognised on the trade date respectively. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

#### Securities at Fair Value through Profit or Loss

Financial assets classified as held for trading are included in the category "securities at fair value through profit or loss". These securities are subsequently valued at quoted market prices. Changes in market value are recognised as an increase or decrease in the value of the securities in the Statement of Financial Position while resulting gains and losses are recognised in the Income Statement.

Where the security is still owned, the gain or loss is reported as Gain/(Loss) from Unrealised Price Revaluations. Where the gain or loss has been realised (through selling the security), this is reported as Gain/(Loss) Realised from Price Changes.

### Foreign Currency Available-for-Sale Investments

Foreign currency available for sale investments are subsequently valued at quoted market prices. Changes in market value are recognised as an increase or decrease in the value of the available for sale securities in the Statement of Financial Position.

Gains and losses arising from changes in the market value of foreign currency available-for-sale investments are recognised on a separate component of equity (shown under Other Reserves in the Statement of Financial Position) until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported as equity is included in income.

### Derivative Instruments

The Bank's involvement in derivative instruments is mainly in forward foreign exchange contracts. Such derivative financial instruments are stated at fair value. The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. All derivative instruments in a gain or loss position, if any, are reported within the balance of foreign currency trading or available for sale securities in the Statement of Financial Position.

### International Monetary Fund (IMF) Related Balances

The Bank transacts with the International Monetary Fund (IMF) in its own right rather than as an agent for the Government of Sri Lanka. All transactions by the Bank with the IMF have been included in these financial statements on that basis.

The Bank records the quota with the IMF as an asset and the amount payable to the IMF for quota is recorded as a liability of the Bank. The cumulative allocation of SDRs by the IMF is treated as a liability. Exchange gains and losses arising on revaluation of IMF assets and liabilities at the exchange rate applying at Statement of Financial Position date as published by the IMF are recognised in the Income Statement.

All other charges and interest pertaining to balances with the IMF are recorded immediately in the Income Statement.

### Cash and Cash Equivalents

Cash and cash equivalents comprise cash at foreign banks and financial institutions and short-term deposits.

As a part of local currency activities CBSL generates certain income and incurs expenses, which do not involve in movement of cash. Those activities result in certain assets and liabilities and mainly comprise of the transactions with the Government of Sri Lanka (GOSL) and transactions with domestic banks and financial institutions. Transactions with

GOSL include the purchase of un-subscribed portions of Treasury bills and bonds that are issued by the Government by the Bank as a monetary policy mechanism. Such purchases, disposals or interest thereon are reflected as mere book entries in the records of CBSL. These are disclosed separately in Note 30 and Note 31 to these Financial Statements.

As the sole statutory authority, CBSL issues currency to the public in line with Monetary Law Act. Currency issued by CBSL represents a claim on the bank in favor of the holder. This is a liability on the part of the CBSL while it is an item of cash in the hands of the holder. Movement in circulation currency is included as part of financing activities in line with prevailing industry practice among those Central Banks which present cash flow statements.

CBSL through the cash/pay order process disburses cash in the form of Notes and Coins or cheques drawn on CBSL, to various drawees including suppliers and employees for goods and services obtained, which is either added to the currency in circulation liability or Deposits by Banks and Financial Institutions. Such forms of utilization of currency for the purposes of CBSL's payments form part of cash outflows of CBSL.

For the purposes of the Statement of Cash Flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of cash/ pay order outflows.

#### **Repurchase and Reverse-Repurchase Transactions**

Securities sold under agreements to repurchase continue to be recorded as assets in the Statement of Financial Position. The obligation to repurchase (Securities Sold under Agreements to Repurchase) is disclosed as a liability. The difference between the sale and repurchase price in repurchase transactions and the purchase price and sale price in reverse-repurchase transactions represents an expense and income respectively and recognised in the Income Statement.

Securities held under reverse-repurchase agreements are recorded as an asset in the Statement of Financial Position (Securities Purchased under Agreements to Re-sell). Both repurchase and reverse-repurchase transactions are reported at the transaction value inclusive of any accrued income or expense.

#### **CBSL Securities**

The Bank issues CBSL Securities from time to time under its Monetary Policy operations to absorb excess liquidity in the market.

The securities issued are recorded as a liability. The difference between the issue price and the face value is recorded as an expense in the Income Statement.

#### **Investment Portfolio – Sri Lanka Government Securities**

The Bank's investment portfolio consists of Treasury bills and bonds purchased from GOSL. The portfolio is recorded in the Statement of Financial Position at amortised cost since they represent loans provided to the GOSL.

#### **Advances to Government**

Advances to Government represents direct provisional advances made to GOSL under Section 89 of the Monetary Law Act No 58 of 1949 of Sri Lanka, as amended.

#### **Loans to Other Institutions**

Loans granted to Other Institutions are recognised and carried at the original granted amount less an allowance for any uncollectible amounts. An allowance for doubtful debts (for loan impairment) is established if there is objective evidence that the Bank will not be able to collect all amounts due. The amount of the allowance is the difference between the carrying amount and the estimated recoverable amount. Bad debts are written off when identified.

#### **Securities Lending**

Transfer of securities to counterparties under lending transactions is only reflected on the Statement of Financial Position if the risks and rewards of ownership are also transferred.

#### **Impairment of Financial Assets**

The Bank assesses at each Statement of Financial Position date whether a financial asset is impaired.

#### **Assets carried at Amortised Cost**

If there is objective evidence that an impairment loss on loans and receivables carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognized in the Income Statement.

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for

which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in the income statement, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

#### **Available-for-Sale Investments**

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in profit or loss, is transferred from equity to the income statement. Reversals in respect of equity instruments classified as available-for-sale are not recognized in profit. Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognized in profit or loss.

#### **Foreign Currency Term Liabilities**

Foreign currency term liabilities are subsequently reported at the amortised cost of the liabilities. Changes in the value of these liabilities are recognised as an increase or decrease in the value of the term liabilities in the Statement of Financial Position. Gains and losses arising from changes in value of foreign currency term liabilities are recognised immediately as expenses in the Income Statement. Where the liability is still owed, the gain or loss is reported as (Gain) /Loss from Unrealised Price Revaluation. Where the gain or loss has been realised (through repayment of the liability), this is reported as (Gains) /Losses Realised from Price Changes.

#### **Financial Guarantees**

Financial Guarantees are initially recognised in the financial statements at fair value. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

#### **Other Financial Assets and Liabilities**

Local and foreign currency cash, deposits and short-term advances are recognised on trade date.

### **3.3 Other Assets and Liabilities**

#### **Gold**

Section 67 (1) of the Monetary Law Act which specifies the composition of the International Reserve indicates that gold may be held by the CBSL as part of this Reserve. Hence, CBSL holds Rs. 84,834,269 in gold as part of its

International Reserves as at 31 December 2009. As this gold is part of the International Reserve and not used as a commodity which is traded during the normal course of business, gold is fair valued and the gains or losses are transferred to the income statement. Prior to appropriation of profits, the unrealised gains or losses from gold are transferred to the relevant reserve account.

#### **Investments in Associates**

The Bank's investments in associates, together with the ones that are held for subsequent disposals are accounted for under cost method.

#### **Inventories**

Inventories are carried at lower of cost and net realisable value. Cost is determined on a weighted average basis. Allowance is made for slow moving inventories.

#### **Property, Plant and Equipment**

Property, Plant and Equipment is stated at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment in value. Such cost includes the cost of replacing part of such Property, Plant and Equipment when that cost is incurred if the recognition criteria are met. Land and buildings are measured at fair value less depreciation on Buildings and impairment charged subsequent to the date of the revaluation.

Except for the freehold land, depreciation is calculated on a straight-line method over the following estimated useful lives.

| <u>Class of Asset</u>         | <u>Useful Life</u>    |
|-------------------------------|-----------------------|
| Buildings on Freehold Lands   | Over 50 Years         |
| Buildings on Lease Hold lands | Over the Lease Period |
| Plant & Plant Integrals       | 20 Years              |
| Furniture & Equipments        | 10 Years              |
| Motor Vehicles                | 5 Years               |
| Computer Hardware             | 4 Years               |
| Others                        | 3 Years               |

The carrying values of plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. Following initial recognition at cost, land and buildings are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation on buildings and subsequent accumulated impairment losses.

Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

Any revaluation surplus is credited to the Revaluation Reserve included in the equity section of the Statement of Financial Position, except to the extent that it reverses a revaluation decrease of the same asset previously recognized in Income Statement, in which case the increase is recognized in Income Statement. A revaluation deficit is recognized in Income Statement, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the Revaluation Reserve. Upon disposal, any revaluation surplus relating to the particular asset being sold is transferred to retained earnings. An item of Property, Plant and Equipment is de-recognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the Income Statement in the year the asset is de-recognized. The asset's residual values, useful life and methods are reviewed, and adjusted if appropriate, regularly.

### **Intangible Assets**

Computer software not integral to computer hardware are shown as intangible assets and recognized at cost. Following initial recognition these intangible assets are carried at cost less any accumulated amortization based on a useful life of 4 years.

### **Receivables**

Receivables are carried at expected realizable value after making due allowance for doubtful debts, based on objective evidence.

### **Sundry Assets**

#### **- Staff Loans**

Bank employees are entitled to loan facilities under concessionary interest rates. These loans are fair valued as per IAS 39 using discounted cash flows.

**Discount rate** - The rate compiled by the Economic Research Department of CBSL (ERD) based on the long term inflation target on USD – Commercial Interest Reference Rate (CIRR) plus 1 per cent added for the risk premium as agreed by the Audit Committee of the Bank is used as the discount rate and it varies with the period of the loans. (upto 15 yrs 10.67% and 15 to 30 years 9.62%).

The difference between the present value of the staff loan as at the end of a year and beginning of the year have been amortized yearly to record the expense incurred by the Bank in providing these loans at concessionary rates and equivalent amount is recorded as other income to record the income that would have earned by the Bank if these loans were granted at market rates.

### **Assumptions used for computation of fair valuation**

- The staff loans granted during the year 2009 is considered.
- The date of staff loan granted is considered as 1st January 2009.
- There were no amendments or settlements for these loans.

Other sundry assets are carried at expected realisable values.

### **Impairment of Non-Financial Assets**

The Bank assesses at each end of reporting period if events or changes in circumstances indicate that the carrying value may be impaired, whether there is an indication that a non-financial asset may be impaired. If any such indication exists, the Bank makes an estimate of the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

### **Provisions**

Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Bank expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

### **Currency in Circulation**

Currency issued by the CBSL represents a claim on the Bank in favour of the holder. The liability for Currency in Circulation is recorded at face value in the Statement of Financial Position.

### **Pension and Other Post Employee Benefit Plans**

Pension and other Post Employment Benefit Plans operated by the Bank are disclosed in Note 36.

### **Defined Benefit Plans**

The Bank operates defined benefit schemes for Pension, Widows' and Orphans' Pensions (W&OP), Widowers' and Orphans' Pensions (WR&OP), Retirement Gratuity and Post Employment Medical Benefits. The Bank and eligible beneficiaries make contributions, to separately administered funds in respect of the first three schemes. The cost of providing benefits under the defined benefit plans is determined separately for each plan using the projected unit credit actuarial valuation method. Actuarial valuations are carried out once in every three years.



The Past service cost is recognised as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits are already vested immediately following the introduction of, or changes to, a benefit plan, past service cost is recognised immediately.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions in excess of the greater of 10% of the value of plan assets or 10% of the defined benefit obligation are charged or credited to income over the employees' expected average remaining working lives, in a systematic method that results in faster recognition of actuarial gains and losses.

#### **Defined Contribution Plans**

Employees are eligible for Employees' Provident Fund and Contributions and Employees' Trust Fund Contributions in line with respective statutes and regulations. The Bank contributes 24% and 3% of employees' gross emoluments to Employees' Provident Fund and Employees' Trust Fund respectively which are separately administered defined contribution plans.

#### **Grants**

Grants recognised at their fair value (where there is a reasonable assurance that the grant will be received and all attaching conditions, if any, will be complied with) are shown under equity. When the grant relates to an expense item it is recognised in the Income Statement over the periods necessary to match them to the expenses it is intended to compensate on a systematic basis. Where the grant relates to an asset, the fair value is credited to a deferred government grant account and is released to the Income Statement over the expected useful life of the relevant asset on a systematic basis consistent with the depreciation policy of the related asset.

#### **Personnel Expenses**

Personnel Expenses include the full cost of all staff benefits. Salaries and related expenses due at year-end are included in other local payables.

#### **Operating Leases**

Where the Bank is the lessee, the lease rentals payable on operating leases are recognised in the Income Statement over the term of the lease on a basis consistent with the expected benefits derived from the leased assets.

#### **Income Tax**

The income of the Bank is exempt from tax under section 118 of the Monetary Law Act 58 of 1949 as amended.

#### **Revenue & Expenses**

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can

be reliably measured. Expenses are recognised in the income statement on the basis of a direct association between the cost incurred and the earning of specific items of income. All expenditure incurred in the running of the business and in maintaining the property, plant & equipment in a state of efficiency has been charged to income in arriving at the result for the year.

The following specific recognition criteria must also be met before revenue and expenses are recognised:

#### **Interest**

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis using the effective yield method based on the actual purchase price unless collectibility is in doubt. Interest income includes coupons earned on fixed income investments and securities and accrued discount and premium on treasury bills and other discounted instruments. Interest income is suspended when loans become doubtful of collection. Such income is excluded from interest income until received.

#### **Dividends**

Dividend income is recognised when the shareholder's right to receive the payment is established.

#### **Miscellaneous**

Miscellaneous income and expenses are recognised on an accrual basis.

Net gains and losses of a revenue nature on the disposal of Property, Plant & Equipment have been accounted for in the Income Statement, having deducted from proceeds on disposal, the carrying amount of the assets and related selling expenses.

Gains and losses arising from incidental activities to the main revenue generating activities and those arising from a group of similar transactions which are not material, are aggregated, reported and presented on a net basis.

#### **Contingent Liabilities and Commitments including Off Statement of Financial Position Items**

All guarantees of indebtedness, forward foreign exchange transactions and other commitments, which represent Off Statement of Financial Position items are shown under respective headings recognised as Off Statement of Financial Position items. Where applicable, such amounts are measured at best estimates.

#### **4. Nature and Extent of Activities**

The Monetary Board of the CBSL is, in addition to determining the policies or measures authorized to be adopted or taken under Monetary Law Act No 58 of 1949 of Sri Lanka as amended, vested with the powers, duties and functions of the CBSL and be generally responsible for the

management, operations and administration of the Bank. The Bank is primarily responsible for the administration supervision, regulation of monetary, financial, and payment system of Sri Lanka and also acts as the fiscal agent of the Government. The activities of the Bank mainly include:

- Implementing monetary and exchange rate policies.
- Issuing of currency.
- Facilitating free competition and stability in the financial system.
- Licensing and supervision of defined financial institutions.
- Organization and management of the inter-bank settlement system and promotion of the smooth functioning of the payments system.
- Providing loans and advances to the Government, bank and financial institutions under various facilities.
- Acting as a depository of the Government under specific arrangements with Government and agencies acting on behalf of the Government.

The activities carried out in order to achieve its objective of economic, price and financial system stability with a view to encouraging and promoting the development of the productive resources of Sri Lanka can be broadly segregated into foreign currency and local currency activities. Results of these activities are taken to mean Operating Activities in the context of the Income Statement.

#### Foreign Currency Activities

Foreign currency activities result mainly from the CBSL's holdings of foreign currency assets under its foreign reserves management function. The foreign reserves management portfolio comprises foreign currency assets held for foreign exchange intervention purposes and other foreign currency assets held for trading purposes.

The foreign currency assets are held in various currencies. The majorities are denominated in United States Dollars, Australian Dollars, Euros, Sterling Pounds and Japanese Yen. The financial instruments held within these foreign currency portfolios consist mainly of sovereign securities, securities held under reverse-repurchase transactions or balances held with other central banks, commercial banks and custodial institutions.

The CBSL also holds, from time-to-time, foreign currency assets and liabilities that arise from international market operations.

#### Local Currency Activities

Local currency activities arise as follows:

- (i) Liquidity management operations. Liquidity management largely involves the CBSL offsetting the daily net flows

to or from government or market by advancing funds to or withdrawing funds from the banking system. Most of this business is undertaken through daily open market operations.

- (ii) Holding an investment portfolio comprising Sri Lanka government securities to support the liability for currency in circulation. The Bank's policy is to hold these investments for monetary operations and not for trading.

#### Trust and Custodial Activities

Amounts administered by the CBSL under custodial and administration arrangements are not included in these financial statements, as they do not form part of elements of financial statements of the Bank.

#### 5. Financial Assets

|  | 2009<br>Rs. '000          | 2008<br>Rs. '000         |
|--|---------------------------|--------------------------|
| Securities at Fair Value through Profit or Loss Available for Sale | 56,275,323                | 50,381,845               |
| Investments  | <u>315,342,452</u>        | <u>41,733,314</u>        |
| <b>Total Financial Assets</b>                                      | <b><u>371,617,775</u></b> | <b><u>92,115,159</u></b> |

#### 6. IMF Related Assets

|                                   | 2009<br>Rs. '000         | 2008<br>Rs. '000         |
|-----------------------------------|--------------------------|--------------------------|
| Holding in Special Drawing Rights | 2,286,331                | 220,853                  |
| IMF Quota                         | 73,860,938               | 72,041,564               |
| Deposit with IMF                  | 140,929                  | 137,458                  |
| Pre paid commitment Fee           | 221,583                  | -                        |
| <b>Total IMF Related Assets</b>   | <b><u>76,509,781</u></b> | <b><u>72,399,875</u></b> |

#### Holding of Special Drawing Rights

Holding of Special Drawing Rights (SDR) is potentially a claim on the freely usable currencies of IMF members, in that holders of SDRs can exchange their SDRs for these currencies. The SDRs value as a reserve asset derives from the commitments of members to hold and accept SDRs, and to honor various obligations connected with the operation of the SDR system. The IMF ensures that the SDRs claim on freely usable currencies is being honored in two ways: by designating IMF members with a strong external position to purchase SDRs from members with weak external positions, and through the arrangement of voluntary exchanges between participating members in a managed market. The amount shown above represents the total holding of the Bank as at the respective Statement of Financial Position dates.

#### IMF Quota

The International Monetary Fund (IMF) is an international organization of 186 member countries. It was established to promote international monetary cooperation, exchange

stability, and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment. Quotas (capital subscriptions) are the primary source of IMF resources. The IMF receives its resources from its member countries. Each country's subscription, or quota, is determined broadly on the basis of the economic size of the country, and taking into account quotas of similar countries. Upon joining the IMF, a country must pay 25 percent of its quota in widely accepted foreign currencies or SDRs, and the remaining 75 percent in its own currency.

A member's quota delineates basic aspects of its financial and organizational relationship with the IMF, including:

- **Subscriptions.** A member's subscription to IMF resources is equal to its quota and determines the maximum amount of financial resources the member is obliged to provide to the IMF. A member must pay its subscription in full: up to 25 percent must be paid in reserve assets specified by the IMF (SDRs or usable currencies), and the rest in the member's own currency.
- **Voting power.** The quota defines a member's voting power in IMF decisions. Each IMF member has 250 basic votes plus one additional vote for each SDR 100,000 of quota.
- **Access to financing.** The amount of financing a member can obtain from the IMF (access limits) is based on its quota. Under Stand-By and Extended Arrangements, for instance, a member can currently borrow up to 200 percent of its quota annually and 600 percent cumulatively. Access may be higher in exceptional circumstances and to meet specific problems.
- **SDR allocations.** Members' shares of SDR allocations are established in proportion to their quotas.

IMF quota therefore represents an asset, and the Bank transacting with the IMF in its own right rather than as an agent for the GOSL, reflects IMF Quota as an asset in its financial statements. The amounts payable in respect of the IMF Quota is shown under the heading Quota Liability in Note 15.

#### PRGF – HIPC Trust Deposit

The PRGF-HIPC (Poverty Reduction Growth Facility for the Heavily Indebted Poor Countries) Trust Deposit was made under the agreement between the GOSL and the IMF on 21<sup>st</sup> April 2000 by transferring SDR 788,783 from Sri Lanka's deposit in the post SCA-2 (Special Contingent Account) administered account with the IMF. This account was created under the guidance of the IMF by transferring the balance held in SCA-2 against Sri Lanka when it was decided to wind up SCA-2 by the IMF. IMF requested the countries that had

balances in the Post SCA-2 account to consider providing the balances in that account to the PRGF/HIPC trust either as outright grant or as a means of providing a subsidy for PRGF/HIPC Loan. Accordingly GOSL agreed to transfer the funds from Post SCA –2 accounts to PRGF/HIPC trust account, not as an outright grant, but as an interest free deposit until 2018.

#### 7. Advances to Government

|                                     | 2009<br><u>Rs. '000</u>  | 2008<br><u>Rs. '000</u>  |
|-------------------------------------|--------------------------|--------------------------|
| Revolving Credit                    | 73,880,500               | 76,307,700               |
| <b>Total Advances to Government</b> | <b><u>73,880,500</u></b> | <b><u>76,307,700</u></b> |

As per Section 89 of the Monetary Law Act No: 58 of 1949 of Sri Lanka, as amended, the CBSL may make direct provisional advances to the GOSL to finance expenditure authorised to be incurred out of the Consolidated Fund, provided that every such advance shall be repayable within a period not exceeding six months, and the total outstanding at anytime shall not exceed ten percent of the estimated revenue of the GOSL for the financial year in which they are made. The above balance represents such advances made by the Bank.

#### 8. Loans to Other Institutions

|  | 2009<br><u>Rs. '000</u> | 2008<br><u>Rs. '000</u> |
|--|-------------------------|-------------------------|
| <b>Capital Outstanding</b>   |                         |                         |
| Related Parties  | 45,919                  | 48,058                  |
| Others   | <u>2,104,829</u>        | <u>2,148,718</u>        |
|  | <u>2,150,748</u>        | <u>2,196,776</u>        |
| <b>Receivable under Susahana Tsunami Loan Scheme</b>               |                         |                         |
| Related Parties  | 604,632                 | 821,613                 |
| Others   | <u>512,558</u>          | <u>737,404</u>          |
| Interest Receivable  | 4,217,766               | 4,220,236               |
| <b>Less: Suspended Interest Allowance for Doubtful Receivables</b> | <b>(4,217,766)</b>      | <b>(4,220,236)</b>      |
| <b>Net Receivable</b>  | <b><u>1,136,596</u></b> | <b><u>1,577,301</u></b> |

Movement in Allowance for Doubtful Receivables is as follows:

|  | 2009<br><u>Rs. '000</u> | 2008<br><u>Rs. '000</u> |
|--|-------------------------|-------------------------|
| At the beginning of the year                   | 2,178,492               | 2,178,492               |
| Movement in Allowance for Doubtful Receivables | <b>(47,150)</b>         | -                       |
| <b>At the end of the year</b>                  | <b><u>2,131,342</u></b> | <b><u>2,178,492</u></b> |

The aggregate amount of non-performing loans on which interest was not recognised amounted to Rs. 2,150,748 as at 31 December 2009 (2008 Rs. 2,196,776). Unrecognised interest related to such loans amounted to Rs. 4,217,766 as at 31 December 2009 (2008 Rs. 4,220,236).

### 9. Investments in Financial and Other Institutions

(a) The Monetary Law Act No. 58 of 1949 of Sri Lanka, as amended, specifically prohibits the Bank from engaging in trade or otherwise having a direct interest in any commercial, industrial or other undertaking or to purchase shares of other banking institutions in the normal course of business. However, the Act authorises the Bank to acquire and hold shares in any company, which in the opinion of the Monetary Board was formed for the advancement and promotion of human resources and technological development in the banking and financial sector or to facilitate clearance of transactions among commercial banks operating in Sri Lanka.

(b) Based on the above requirements, the Bank holds the following investments as at the Statement of Financial Position date:

| Investee   | Business                        | % Holding |       | Year End    |
|--|---------------------------------|-----------|-------|-------------|
|  |                                 | 2009      | 2008  |             |
| LankaClear (Pvt) Ltd   | Automated Clearing              | 19.66     | 19.66 | 31 March    |
| Fitch Ratings Lanka Ltd  | Credit Rating                   | 10.00     | 10.00 | 31 December |
| Lanka Financial Service Bureau Limited                             | Automated Fund Transfers        | 7.50      | 7.50  | 31 December |
| Credit Information Bureau of Sri Lanka Ltd                         | Provision of Credit Information | 19.9      | 19.9  | 31 December |
| <b>Held for Sale</b><br>Credit Information Bureau of Sri Lanka Ltd | Provision of Credit Information | 8.51      | 31.04 | 31 December |

As per the section 8(5)(a) of the Credit Information Bureau of Sri Lanka (Amendment) Act, No. 42 of 2008, the Monetary Board (MB) shall retain not less than fifteen per centum of the issued share capital of the Bureau.

Accordingly, MB will retain 19.9% of such shares and the excess is being re distributed among the existing state owned members. During the year 2009, 22.53% of CBSL's holding were divested & certain administrative formalities are being attended to, for the devestiture of the balance 8.51% which is recorded as held for sale. As these are held for subsequent disposal, the investment is accounted for under cost method.

(c) The carrying value of investments in the respective entities is as follows:

|  | 2009<br>Rs. '000 | 2008<br>Rs. '000 |
|--|------------------|------------------|
| Credit Information Bureau Ltd                                | 6,027            | 6,027            |
| Lanka Clear (Pvt) Ltd  | 29,500           | 29,500           |
| Fitch Ratings Lanka Ltd                                      | 3,500            | 3,500            |
| Lanka Financial Services Bureau Ltd.                         | 2,250            | 2,250            |
|  | <b>41,277</b>    | <b>41,277</b>    |
| <b>Held for sale</b>   |                  |                  |
| Credit Information Bureau Ltd                                | 2,578            | 9,452            |
| <b>Total Investments in Financial and Other Institutions</b> | <b>43,855</b>    | <b>50,729</b>    |

### 10. Inventories

|  | 2009<br>Rs. '000 | 2008<br>Rs. '000 |
|--|------------------|------------------|
| Notes for Circulation  | 1,687,046        | 1,539,696        |
| Coins for Circulation  | 391,615          | 440,791          |
| Coins in Transit   | 68,587           | 7,739            |
|  | <b>2,147,248</b> | <b>1,988,226</b> |
| <b>Less: Allowance for Slow Moving Items</b>                       | <b>(25,000)</b>  | <b>(55,300)</b>  |
|  | <b>2,122,248</b> | <b>1,932,926</b> |
| Stationery and Sundry Inventory                                    | 34,952           | 28,761           |
| <b>Total Inventories at Lower of Cost and Net Realisable Value</b> | <b>2,157,200</b> | <b>1,961,687</b> |

| <b>11. Properties, Plant and Equipment</b>  |                            |                                    |                                  |                       |                          |                 |                   |                   |
|---|----------------------------|------------------------------------|----------------------------------|-----------------------|--------------------------|-----------------|-------------------|-------------------|
|   | <b>Land and Buildings</b>  | <b>Plant &amp; Plant Integrals</b> | <b>Furniture &amp; Equipment</b> | <b>Motor Vehicles</b> | <b>Computer Hardware</b> | <b>Others</b>   | <b>Total 2009</b> | <b>Total 2008</b> |
|   | <b>Rs. '000</b>            | <b>Rs. '000</b>                    | <b>Rs. '000</b>                  | <b>Rs. '000</b>       | <b>Rs. '000</b>          | <b>Rs. '000</b> | <b>Rs. '000</b>   | <b>Rs. '000</b>   |
| <b>At 1 January net of Accumulated</b>  |                            |                                    |                                  |                       |                          |                 |                   |                   |
| <b>Depreciation</b>   | <b>8,056,962</b>           | <b>730,657</b>                     | <b>176,669</b>                   | <b>71,413</b>         | <b>47,230</b>            | <b>160,056</b>  | <b>9,242,987</b>  | 9,354,647         |
| Additions   | 178,448                    | 9,915                              | 40,565                           | 1,323                 | 53,332                   | 98,142          | 381,724           | 199,674           |
| Disposals   |                            |                                    | (4,592)                          | -                     | (770)                    | -               | (5,362)           | (13,635)          |
| Net effect of   |                            |                                    |                                  |                       |                          |                 |                   |                   |
| Reclassification / Written off  | -                          | -                                  | -                                | -                     | -                        | -               | -                 | -                 |
| Depreciation charge for the year  | (122,195)                  | (52,665)                           | (43,357)                         | (27,254)              | (29,378)                 | (1,553)         | (276,401)         | (297,698)         |
| <b>At 31 December Net of Accumulated</b>  |                            |                                    |                                  |                       |                          |                 |                   |                   |
| <b>Depreciation</b>   | <b>8,113,214</b>           | <b>687,907</b>                     | <b>169,285</b>                   | <b>45,482</b>         | <b>70,414</b>            | <b>256,645</b>  | <b>9,342,947</b>  | 9,242,988         |
| <b>At 01 January</b>  |                            |                                    |                                  |                       |                          |                 |                   |                   |
| <b>Gross Carrying Amount</b>  |                            |                                    |                                  |                       |                          |                 |                   |                   |
| At cost   | 8,367,062                  | 1,061,420                          | 604,440                          | 214,713               | 752,416                  | 283,012         | 11,283,063        | 2,739,731         |
| At revaluation  | -                          | -                                  | -                                | -                     | -                        | -               | -                 | 8,166,968         |
| <b>Accumulated Depreciation</b>   |                            |                                    |                                  |                       |                          |                 |                   |                   |
| At cost   | (253,847)                  | (373,512)                          | (435,155)                        | (169,231)             | (682,002)                | (26,366)        | (1,940,115)       | (1,533,462)       |
| At revaluation  | -                          | -                                  | -                                | -                     | -                        | -               | -                 | (130,250)         |
| <b>Net Carrying Amount</b>  | <b>8,113,214</b>           | <b>687,907</b>                     | <b>169,285</b>                   | <b>45,482</b>         | <b>70,414</b>            | <b>256,645</b>  | <b>9,342,947</b>  | 9,242,988         |
| <b>12. Intangible Assets</b>  |                            |                                    |                                  |                       |                          |                 |                   |                   |
| Land and buildings are recorded at fair value. The latest independent valuation was performed as at 31 December 2007 by P B Kalugalagedara (Chartered Valuer), which was recorded as at 31 December 2007. |                            |                                    |                                  |                       |                          |                 |                   |                   |
| Composition of Land and Buildings is as follows:  |                            |                                    |                                  |                       |                          |                 |                   |                   |
|   | <b>Carrying Value 2009</b> | <b>Carrying Value 2008</b>         |                                  |                       |                          |                 |                   |                   |
|   | <b>Rs. '000</b>            | <b>Rs. '000</b>                    |                                  |                       |                          |                 |                   |                   |
| Freehold land   | 2,942,747                  | 2,839,300                          |                                  |                       |                          |                 |                   |                   |
| Buildings on Freehold Land  | 5,078,799                  | 5,149,326                          |                                  |                       |                          |                 |                   |                   |
| Buildings on Leasehold Land   | 91,668                     | 68,336                             |                                  |                       |                          |                 |                   |                   |
|   | <b>8,113,214</b>           | <b>8,056,962</b>                   |                                  |                       |                          |                 |                   |                   |
| <b>Computer Software:</b>   |                            |                                    |                                  |                       |                          |                 |                   |                   |
|   | <b>2009</b>                | <b>2008</b>                        |                                  |                       |                          |                 |                   |                   |
|   | <b>Rs. '000</b>            | <b>Rs. '000</b>                    |                                  |                       |                          |                 |                   |                   |
| <b>Cost:</b>  |                            |                                    |                                  |                       |                          |                 |                   |                   |
| As at 1 January   | 484,459                    | 464,420                            |                                  |                       |                          |                 |                   |                   |
| Additions   | 6,712                      | 20,039                             |                                  |                       |                          |                 |                   |                   |
| Disposals   | -                          | -                                  |                                  |                       |                          |                 |                   |                   |
| <b>As at 31 December</b>  | <b>491,171</b>             | <b>484,459</b>                     |                                  |                       |                          |                 |                   |                   |
| <b>Amortisation and Impairment:</b>   |                            |                                    |                                  |                       |                          |                 |                   |                   |
| As at 1 January   | 468,742                    | 463,467                            |                                  |                       |                          |                 |                   |                   |
| Amortisation Charge for the year  | 6,046                      | 5,275                              |                                  |                       |                          |                 |                   |                   |
| <b>As at 31 December</b>  | <b>474,788</b>             | <b>468,742</b>                     |                                  |                       |                          |                 |                   |                   |
| <b>Net Book Value:</b>  |                            |                                    |                                  |                       |                          |                 |                   |                   |
| As at 1 January   | 15,717                     | 953                                |                                  |                       |                          |                 |                   |                   |
| <b>As at 31 December</b>  | <b>16,383</b>              | <b>15,717</b>                      |                                  |                       |                          |                 |                   |                   |
| <b>13. Amounts Payable to Banks and Financial Institutions</b>  |                            |                                    |                                  |                       |                          |                 |                   |                   |
|   | <b>2009</b>                | <b>2008</b>                        |                                  |                       |                          |                 |                   |                   |
|   | <b>Rs. '000</b>            | <b>Rs. '000</b>                    |                                  |                       |                          |                 |                   |                   |
| Payable to Foreign Banks  | 17,709,419                 | -                                  |                                  |                       |                          |                 |                   |                   |
| Payable to other Foreign Financial Institutions   | 359,422                    | 336,091                            |                                  |                       |                          |                 |                   |                   |
| <b>Total Amount Payable to Banks and Financial Institutions</b>   | <b>18,068,841</b>          | <b>336,091</b>                     |                                  |                       |                          |                 |                   |                   |

**14. Amounts Payable to the Asian Clearing Union**

|                                   | 2009<br>Rs. '000 | 2008<br>Rs. '000 |
|-----------------------------------|------------------|------------------|
| Payable as at the end of the year | 29,836,531       | 91,354,909       |

The Asian Clearing Union (ACU) was established in 1974 under the auspices of the Economic and Social Commission for Asia and the Pacific as a mechanism for settlement of payments among participating countries' central banks. Sri Lanka is one of the participants. The other participants are Bangladesh, the Islamic Republic of Iran, Nepal, Pakistan, India, Bhutan and Myanmar. This is a clearing facility to settle, on a multilateral basis, payments for current international transactions among territories of participants. Net position as at end of each month is settled or received, after two-month credit period. Interest between 0.18 % and 0.14 % in USD (2008- 0.27% and 3.94%) & Interest between 0.28 % and 0.30 % in EUR is paid by net debtors to the facility and transferred to net creditors on daily balances outstanding between settlement dates. Above balance represents the amounts due to ACU at the respective Statement of Financial Position dates.

**15. IMF Related Liabilities**

|                                      | 2009<br>Rs. '000          | 2008<br>Rs. '000         |
|--------------------------------------|---------------------------|--------------------------|
| Interest Bearing Loans – Non Current | <u>78,899,615</u>         | <u>7,534,695</u>         |
| Interest Bearing Loans – Current     | 3,301,811                 | 11,543,903               |
| Allocation of Special Drawing Rights | 70,655,689                | 12,349,883               |
| Other Amounts                        |                           |                          |
| Payable to IMF                       | 41,627,642                | 39,987,545               |
| Quota Liability                      | 23,686,264                | 23,717,632               |
|                                      | <u>139,271,406</u>        | <u>87,598,963</u>        |
| <b>Total IMF Related Liabilities</b> | <b><u>218,171,021</u></b> | <b><u>95,133,658</u></b> |

Interest bearing Loans consist of Poverty Reduction & Growth Facility (PRGF), Extended Fund Facility (EFF) as well as Emergency Assistance Facility (EAF) with the IMF.

**Poverty Reduction & Growth Facility (PRGF)**

PRGF is a long term financing facility given by IMF to its lower income-earning members. This arrangement was previously known as Enhanced Structural Adjustment Facility (ESAF). The main aim of this program is to reduce poverty and to promote high growth on a sustainable basis leading to higher living standards. The interest rate levied on PRGF loans is 0.5 percent per annum. The repayment period given for such loans by IMF is over a maximum period of 10 years.

The reforms undertaken under PRGF would include:

- Continued fiscal consolidation.

- Labour market reforms.
- Public enterprise restructuring & privatization.
- Reform of the public administration.
- Removal of impediments to foreign direct investment.
- Substantial increase in public expenditure on infrastructure development.

**Extended Fund Facility (EFF)**

EFF is an IMF financing facility that supports medium term programs that seek to overcome Balance of Payment difficulties stemming from macroeconomic imbalances & structural problems. This is an extended facility of Enhanced Structural Adjustment Facility (ESAF). The interest rate levied on EFF loan is 0.5 percent per annum. The repayment period given for this loan by IMF is over a period of 10 years with a grace period of 4 1/2 years.

The reforms undertaken under this facility would include:

- Fiscal consolidation.
- Reforming the financial sector.
- Reforming public enterprises & trade regime.
- Labour market regulations.
- Strengthening macroeconomic policy instruments & institutions.

**Emergency Assistance Facility (EAF)**

The IMF provides an emergency assistance to member countries hit by natural disasters to help them meet immediate balance of payments financing needs and maintain or restore macro economic stability. The Executive Board of the IMF has approved SDR 103,350 in emergency assistance for Sri Lanka. The emergency assistance will be repaid in eight equal quarterly installments over 3 1/4 to 5 years from the disbursement date.

The amounts expected to be settled before and after 12 months in connection with Interest Bearing Loans are as follows:

|                                     | Effective<br>Interest rate % | Maturity | 2009<br>Rs. '000         | 2008<br>Rs. '000         |
|-------------------------------------|------------------------------|----------|--------------------------|--------------------------|
| <b>Current</b>                      |                              |          |                          |                          |
| EFF                                 | 1.23                         |          | 307,754                  | 1,200,693                |
| PRGF2                               | 0.5                          |          | 685,903                  | 1,338,014                |
| EAF                                 | 1.23                         |          | 2,308,154                | 9,005,196                |
|                                     |                              |          | <u>3,301,811</u>         | <u>11,543,903</u>        |
| <b>Non-current</b>                  |                              |          |                          |                          |
| SBA                                 |                              | 2014     | 73,860,937               | -                        |
| PRGF 2                              | 0.5                          | 2013     | 4,115,416                | 4,683,050                |
| EFF                                 | 1.23                         | 2010     | 923,262                  | 600,346                  |
| EAF                                 | 1.23                         | 2010     | -                        | 2,251,299                |
|                                     |                              |          | <u>78,899,615</u>        | <u>7,534,695</u>         |
| <b>Total Interest bearing Loans</b> |                              |          | <b><u>82,201,426</u></b> | <b><u>19,078,598</u></b> |

### Allocation of Special Drawing Rights

The SDR is a reserve asset created by the IMF in order to meet a long-term global need to supplement existing reserve assets. SDRs are allocated to member countries in proportion to their IMF quotas. SDR allocations can only be made to countries that participate in the IMF's SDR Department (an accounting unit within the IMF). The IMF to supplement existing official reserve assets, such as gold holdings, foreign exchange, and reserve positions in the IMF, created SDRs. Under certain conditions, which are set in the Articles of Agreement signed on behalf of the Government of Sri Lanka by the Bank, the IMF may allocate SDRs to members in proportion to their IMF quotas. An allocation of SDRs by the IMF provides each member with a costless asset on which interest is neither earned nor paid. The Articles of Agreement also allow for cancellations of SDRs, but to date, this provision has not been used. Increases in Allocation of SDR represents increases in Holding of SDR as described in Note 6. Members of IMF shall be obligated to pay to the IMF an amount equal to its net cumulative allocation and any other amounts that may be due and payable because of its participation in the Special Drawing Rights Department at the point of termination or liquidation of IMF's SDR Department.

### Other Amounts Payable to IMF

These represent amounts owed by the Bank to IMF on account of operational and administrative transactions.

### Quota liability

The amounts payable in respect of the IMF Quota as described in Note 6 is shown under the heading Quota Liability.

### Stand By Arrangement (SBA)

This is the highest loan facility offered by IMF to Sri Lanka. The executive board of the IMF approved a 20-month stand by arrangement for Sri Lanka in an amount equivalent to SDR 1.65 billion (USD 2.6 billion) on 24th July 2009 to Sri Lanka as a balance of payment (BOP) support. On 28th July 2009 and 10th November 2009 two tranches of the loan equivalent to a total of SDR 413.4 million (USD 644.4 million) were received by Sri Lanka. The remaining amount will be phased in six tranches subject to quarterly reviews on economic performance of the country. The total loan facility made by the IMF equals 400% of the Sri Lanka's Quota.

Under the 20-month SBA Program, the final tranche will be disbursed in March 2011. The loan is repayable within 4 years commencing April 2012. The rate of interest of the SBA facility is composed of two components; the service charge and a fixed margin.

### The key objectives of the SBA are as follows,

- To support the country's economic reform program.

- To strengthen the country's fiscal position while ensuring the availability of resources for much needed post-conflict reconstruction & relief efforts.
- Intend to rebuild international reserves and strengthen Sri Lanka's domestic financial system.
- To lay a strong macroeconomics foundation that will help the authorities approach the boarder international community for financial support in post conflict reconstruction.
- Reducing the central government budget deficit to 5% of GDP by 2011 from a target of 7% of GDP this year.
- To strengthen the banking system by improving the current regulatory framework and enhancing bank supervision.

### 16. Other Foreign Payables

|                                     | 2009<br>Rs. '000 | 2008<br>Rs. '000 |
|-------------------------------------|------------------|------------------|
| Other Foreign Liabilities           | 2,148,425        | 1,517,077        |
| China Development Bank (CDB) Loan   | 2,859,610        | -                |
| <b>Total Other Foreign Payables</b> | <b>5,008,035</b> | <b>1,517,077</b> |

### China Development Bank Loan (CDB)

CBSL entered into an agreement with the China Development Bank (CDB) on 25th July 2009 to promote financial and economic co-operation between the two institutions. Under this agreement, CDB will make available a credit facility in an aggregate amount up to the commitment of USD 25 million and CBSL will apply the proceeds of the facility for the purpose of financial stability of the country enhancing liquidity of the market and promoting the development of agriculture, infrastructure in Sri Lanka.

Interest is calculated using the 6 months USD LIBOR plus a margin of 4%.

CBSL has to repay the facility in full on the final maturity date, the date falling thirty-six months after utilization date (14.08.2009).

### 17. Deposits by Banks and Financial Institutions

Under the mechanism of Real Time Gross Settlement System (RTGS), participants, which include licensed commercial banks, primary dealers and the Employee Provident Fund, can obtain the required funds for honouring payments under an interest free, fully collateralized intra-day liquidity facility. The participants are required to pledge tradable government securities to obtain such intra-day liquidity facility. An advance under Intra-day Liquidity Facility represents such

amounts advanced against tradable Government Securities, which stood at zero as at both year-ends.

|   | 2009<br>Rs. '000  | 2008<br>Rs. '000  |
|---|-------------------|-------------------|
| <b>Deposits by Banks</b>  |                   |                   |
| - Related Parties   | 36,556,496        | 33,347,603        |
| - Others  | 49,525,894        | 48,960,685        |
|   | <u>86,082,390</u> | <u>82,308,288</u> |
| <b>Deposits by Financial Institutions</b>                       |                   |                   |
| - Related Parties   | 132               | 91                |
| - Others  | 3,344             | 2,836             |
|   | <u>3,476</u>      | <u>2,926</u>      |
| <b>Total Deposits by Banks and Other Financial Institutions</b> | <u>86,085,866</u> | <u>82,311,214</u> |

#### 18. (a) Balances with Government and Governmental Entities

|   | 2009<br>Rs. '000 | 2008<br>Rs. '000 |
|---|------------------|------------------|
| Government Deposits   | 1,414,039        | 341,343          |
| Government Agencies and Funds                                   | 933,670          | 904,281          |
| <b>Total Balances with Government and Governmental Entities</b> | <u>2,347,709</u> | <u>1,245,624</u> |

#### (b) Securities sold under agreement to repurchase

|   | 2009<br>Rs. '000  | 2008<br>Rs. '000  |
|---|-------------------|-------------------|
| Government Securities   | 6,000,000         | 13,743,000        |
| CBSL Securities   | 78,022,645        | -                 |
| <b>Total Balances with Government and Governmental Entities</b> | <u>84,022,645</u> | <u>13,743,000</u> |

#### 19. Balances with Employee Benefit Plans

The Bank as a part of normal activities act as the bank for its employee benefit plans. The amounts held in credit of these separately administered employee benefit plans of the Bank, are as follows:

|  | 2009<br>Rs. '000 | 2008<br>Rs. '000 |
|--|------------------|------------------|
| Employee Provident Fund                            |                  |                  |
| - Related Party                                    | 1,083            | 2,563            |
| Employee Retirement Pension Scheme - Related Party | (481,359)        | (482,438)        |
| Widows' /Widowers' & Orphans' Pension Schemes      |                  |                  |
| - Related Party                                    | 667,955          | 704,166          |
| Payable in respect of Gratuity                     | 19,162           | 39,337           |
| Payable in respect of Medical Benefit Scheme       | 843,415          | 891,433          |
| <b>Total Other Deposits</b>                        | <u>1,050,255</u> | <u>1,155,061</u> |

#### 20. Currency in Circulation

The Bank, as the sole currency issuing authority in Sri Lanka continued to perform the function of issuing legal tender

currency. The amount of currency issued by the Bank and in circulation at respective Statement of Financial Position dates are as follows:

| Denomination              | 2009<br>Rs. '000 | 2008<br>Rs. '000 |
|---------------------------|------------------|------------------|
| <b>Coins:</b>             |                  |                  |
| 1 cent                    | 3,631            | 3,631            |
| 2 cent                    | 5,702            | 5,701            |
| 5 cent                    | 23,249           | 23,247           |
| 10 cent                   | 39,220           | 39,217           |
| 25 cent                   | 120,754          | 120,339          |
| 50 cent                   | 184,190          | 182,833          |
| 1 rupee                   | 574,058          | 539,674          |
| 2 rupee                   | 811,255          | 762,381          |
| 5 rupee                   | 2,501,296        | 2,372,090        |
| 10 rupee                  | 447,287          | 405,241          |
| Other commemorative coins | 546,535          | 337,454          |
|                           | <u>5,257,177</u> | <u>4,791,808</u> |

#### Notes:

|            |             |            |
|------------|-------------|------------|
| 1 rupee    | 4,981       | 4,981      |
| 2 rupee    | 26,699      | 26,700     |
| 5 rupee    | 37,208      | 37,211     |
| 10 rupee   | 1,806,776   | 1,904,330  |
| 20 rupee   | 2,068,244   | 1,899,290  |
| 50 rupee   | 3,052,438   | 2,773,091  |
| 100 rupee  | 12,254,788  | 11,415,696 |
| 200 rupee  | 176,231     | 174,796    |
| 500 rupee  | 18,171,292  | 15,693,067 |
| 1000 rupee | 101,922,111 | 93,189,087 |
| 2000 rupee | 72,651,890  | 54,188,857 |

**Total Currency in Circulation** 217,429,835 186,098,914

#### 21. Deferred Grants

During the year the Bank received Computers, Furniture & Equipment from Asian Development Bank without any consideration. The Assets were recognized in the financial statements at fair value with the corresponding credit recognized as deferred revenue. Deferred revenue is amortized over the period that matches with the depreciation policy of such assets. Total value of the grant was Rs.639 and the amount recognized in the income statement (under other Income) during the year was Rs.72.

#### 22. Equity

##### Nature of Equity Items

##### Capital Funds

*Contributed Capital* - The capital account Rs.15, 000 represents the capital of the Bank in accordance with section 6 of the Monetary Law Act.

##### Reserves Appropriated as Capital

This Reserve is made up by transferring Rs.24, 985,000 out of the General Reserves in 2008, as per the Monetary Board decision of MB/F/22/12/2008.



In addition to the *Retained Earnings*, reserves comprise of the following;

**General Reserve** – The general reserve includes amounts set aside by the Monetary Board in respect of the following reserves – Capital Contribution, Medium & Long Term Credits and Control Account Reserve. The Capital Contribution has been made to build up a fund for use of investment in finance and other entities.

**Surplus and Control Account Reserve** – This comprises of the Surplus Reserve and Control Account Reserve. Surplus reserve is a reserve established in accordance with section 39 (b) of the Monetary Law Act, which requires that the total capital of the CBSL should not be less than 15% of the difference between the total assets of the bank and its assets in gold and foreign currencies. The balance of the Control Account Reserve relates to historic surplus and deficit not allocated to other equity reserves.

**International Revaluation Reserve (IRR)** – International Revaluation Reserve is a reserve established in accordance with section 41 of the Monetary Law Act which requires that any unrealized gain or loss arising from the revaluation of net assets and liabilities of CBSL in gold or foreign currency

shall not be considered in computing the net profit of the bank, instead such profit or loss should be transferred to the International Reserve Revaluation.

**Net Fair Value Gain/(Loss) on Available for Sale Securities**

For the period ended 31 December 2009, unrealized gains and losses on the revaluation of securities designated as available for sale, have been transferred to this reserve.

**RTGS Sinking Fund** - This fund is built up with the charges collected from the participants for use of the RTGS system. The fund is limited to investments in treasury bills and bonds.

**Pension Fund Reserve** - This reserve is made up by transferring an additional Rs.3 billion from 2007 profits to be used to meet any shortfalls in the pension fund given the vulnerability of the income generating capacity of the Bank, to external risks.

**Technical Advancement Reserve** - This reserve is built up from 2007 profits specifically to be used for technical advancement requirements, modification or upgrading of the IT systems currently used by the CBSL i.e., GL, RTGS, TDRMS or SSSS.

The movements in the other reserves are as follows:

|  | Capital Contribution | Medium & Long Term Credit Reserve | Surplus & Control Account/ Mkt. Value and other Reserves | CBSL Specific Reserves | RTGS Sinking Fund | IRR        | Net Fair value/ (Loss) on available for sale securities | Pension Fund Reserves | Technical Advancement Reserves | Total       |
|--|----------------------|-----------------------------------|--|------------------------|-------------------|------------|---|-----------------------|--------------------------------|-------------|
|  | Rs.'000              | Rs.'000                           | Rs.'000  | Rs.'000                | Rs.'000           | Rs.'000    | Rs.'000   | Rs.'000               | Rs.'000                        | Rs.'000     |
| As at 01 January 2009  | -                    | 9,425,000                         | 14,356,691   | 473,194                | 202,864           | 38,611,510 | 1,822,402   | 3,000,000             | 1,000,000                      | 68,891,661  |
| Transfer of RTGS Income to RTGS Fund                                 |                      |                                   |  |                        | 95,043            |            |   |                       |                                | 95,043      |
| Transfer of CBSL Specific Reserve                                    |                      |                                   |  | 269,798                |                   |            |   |                       |                                | 269,798     |
| Transfer of Profits to Market Valuation Reserve                      |                      |                                   | 2,211,883  |                        |                   |            |   |                       |                                | 2,211,883   |
| Transfer of Net Foreign Exchange Revaluation Gain / (Loss)           |                      |                                   |  |                        |                   | 8,842,035  |   |                       |                                | 8,842,035   |
| Net Fair value Gain / (Loss) on Available for sale Securities & gold |                      |                                   |  |                        |                   |            | (2,887,636)   |                       |                                | (2,887,636) |
| As at 31 December 2009   | -                    | 9,425,000                         | 16,568,574   | 742,992                | 297,907           | 47,453,545 | (1,065,234)   | 3,000,000             | 1,000,000                      | 77,422,784  |

### 23. Transfer of Net Profit

Under section 39 (c) of the Monetary Law Act No. 58 of 1949, as amended, the Bank's net profit, as determined in accordance with the Act, is paid to the government after

making necessary appropriations to Reserves under section 38 of the Monetary Law Act. During the period the Bank has transferred Rs.20,000,000 to the government as an advance transfer of 2009 profits.

**24. Interest Income from Financial Assets**

|   | 2009<br>Rs. '000  | 2008<br>Rs. '000  |
|---|-------------------|-------------------|
| <b>Interest Income from Foreign Currency Financial Assets</b>         |                   |                   |
| Cash & Cash Equivalents   | 1,397,611         | 4,670,088         |
| Financial Assets  | 3,181,686         | 6,334,568         |
| IMF Related Assets  | <u>16,559</u>     | <u>124,534</u>    |
| <b>Total Interest Income from Foreign Currency Financial Assets</b>   | <b>4,595,856</b>  | <b>11,129,190</b> |
| <b>Interest Income from Local Currency Financial Assets</b>           |                   |                   |
| Investment Portfolio  |                   |                   |
| – Sri Lanka Government Securities                                     | 27,706,386        | 6,538,858         |
| Other Loans and Advances  | <u>404,951</u>    | <u>504,173</u>    |
| <b>Total Net Interest Income from Local Currency Financial Assets</b> | <b>28,111,337</b> | <b>7,043,031</b>  |
| <b>Total Interest Income from Financial Assets</b>                    | <b>32,707,193</b> | <b>18,172,221</b> |

**25. Interest Expense on Financial Liabilities**

|   | 2009<br>Rs. '000 | 2008<br>Rs. '000 |
|---|------------------|------------------|
| <b>Interest Expense on Foreign Currency Financial Liabilities</b>       |                  |                  |
| Amount Payable to Asian Clearing Union                                  | 24,560           | 869,784          |
| IMF Related Liabilities   | 826,617          | 428,110          |
| USD / LKR SWAPs   | 903,652          | (562)            |
| Other Foreign Payable   | <u>77,607</u>    | <u>4,220</u>     |
| <b>Total Interest Expense on Foreign Currency Financial Liabilities</b> | <b>1,832,436</b> | <b>1,301,552</b> |
| <b>Interest Expense on Local Currency Financial Liabilities</b>         |                  |                  |
| Securities Sold Under Agreements to Repurchase CBSL Securities          | 1,053,305        | 367,705          |
|   | <u>1,481,515</u> | <u>144,004</u>   |
| <b>Total Interest Expense on Local Currency Financial Liabilities</b>   | <b>2,534,820</b> | <b>511,709</b>   |
| <b>Total Interest Expense on Financial Liabilities</b>                  | <b>4,367,256</b> | <b>1,813,261</b> |

**SWAP Cost**—Bank has entered into a SWAP facility with a foreign central bank from February 2009 for USD 200 million & a total of Rs. 101,899 has been paid as the SWAP cost during the year 2009.

**26. Other Income**

|   | 2009<br>Rs. '000 | 2008<br>Rs. '000 |
|---|------------------|------------------|
| Dividend Income   |                  |                  |
| – Related Party   | 25,163           | 9,048            |
| – Others  | 863              | -                |
| Loss on Disposal of Property, Plant & Equipment                     | (741)            | 1,708            |
| Gain on disposal of Investments in Financial and other Institutions | 103,143          | 308              |
| Amortization of Deferred Grant                                      | 72               | 68               |
| Miscellaneous Income  | <u>415,717</u>   | <u>443,118</u>   |
| <b>Total Other Income</b>   | <b>544,217</b>   | <b>454,250</b>   |

**27. Personnel Expenses**

|  | 2009<br>Rs. '000 | 2008<br>Rs. '000 |
|--|------------------|------------------|
| Wages and salaries including PAYE paid by the employer | 2,128,264        | 1,718,302        |
| Defined Contribution Plan Costs                        | 276,101          | 215,066          |
| Post Employee Defined Benefit Plan Costs               | -                | 1,333,944        |
| <b>Total Personnel Expenses</b>                        | <b>2,404,365</b> | <b>3,267,312</b> |

**28. Administration Expenses**

|   | 2009<br>Rs. '000 | 2008<br>Rs. '000 |
|---|------------------|------------------|
| Repairs and Maintenance                       | 472,315          | 441,637          |
| Information                                   | 61,687           | 77,242           |
| Operational Travel                            | 39,210           | 48,532           |
| Rental Expenses                               | 717              | 1,217            |
| Printing                                      | 28,492           | 23,830           |
| Audit Fees                                    | 7,700            | 8,688            |
| Remuneration to members of the Monetary Board | 509              | 383              |
| Interest Expense on CBSL Provident Fund       | -                | 468,165          |
| Miscellaneous                                 | <u>302,677</u>   | <u>402,563</u>   |
| <b>Total Other Operating Expenses</b>         | <b>913,307</b>   | <b>1,472,257</b> |

**29. Income Tax**

As per the Inland Revenue (Amendment) Act, No. 10 of 2007, dividend or interest will be liable to 10% withholding tax at the time of payment or crediting. The withholding tax on the interest income on the Government Securities is based on the weighted average yield rate of the closest primary auction adjusted to the days to maturity.

During the period an amount of Rs. 1,516,373 (2008 – Rs. 1,877,740) was expensed in relation to such withholding tax, payable on interest income of Rs. 19,013,069 (2008 – Rs. 21,441,815) & dividend income of Rs. 26,026 (2008 – Rs. 9,048). In addition, the Bank paid Economic Service Charge amounting to Rs. 120,000 in 2009 (2008 – Rs. 60,000).

| <b>30. Reconciliation of Operating Profit with Operating Cash Flow</b> |                         |                         | <b>31. Issues / (Withdrawals) of Circulation Currency on Government Transactions</b>                          |                         |                         |
|--|-------------------------|-------------------------|---|-------------------------|-------------------------|
|  | 2009<br><u>Rs. '000</u> | 2008<br><u>Rs. '000</u> |   | 2009<br><u>Rs. '000</u> | 2008<br><u>Rs. '000</u> |
| <b>Reported Net Profit from</b>  |                         |                         |   |                         |                         |
| <b>Operating Activities</b>  | <b>33,638,649</b>       | (5,044,424)             | Purchases of Government of Sri Lanka Securities for Investment Portfolio                                      | <b>(114,576,052)</b>    | 114,186,270             |
| <b>Add /(Subtract) Non-Cash Items</b>                                  |                         |                         | Interest Received – Local Currency  |                         |                         |
| Depreciation   | 295,759                 | 302,977                 | Investment Portfolio Increase /(Decrease) in Loans and Advances to GOSL                                       | <b>(29,451,452)</b>     | (4,565,637)             |
| Interest Received – Local Currency – Investment Portfolio              | -                       | (6,538,858)             | (Increase) /Decrease Balances with Government and Government Entities   | <b>(2,427,200)</b>      | 15,253,700              |
| Bad debt Written-Off/ (Written Back)                                   | <b>(27,706,386)</b>     | -                       |   | <b>(1,102,085)</b>      | 545,151                 |
| Provision for Post Employment Defined Benefits Plans                   | <b>(44,945)</b>         | 4,682,839               |   | <b>(147,556,788)</b>    | 125,419,484             |
| Gross Unrealised Foreign Exchange (Gain) /Loss                         | <b>(8,168,560)</b>      | 22,541,075              | <b>32. Net Issues / (Withdrawals) of Circulation Currency on Bank and Financial Institutions Transactions</b> |                         |                         |
| Other Provision  | <b>23,042,373</b>       | 21,329,329              |   | 2009<br><u>Rs. '000</u> | 2008<br><u>Rs. '000</u> |
| Deferred Grants  | <b>(72)</b>             | (68)                    | (Increase) /Decrease in Balances with Banks and Financial Institutions  | <b>(4,149,819)</b>      | 8,741,810               |
| Provision for slow moving inventory written back                       | <b>(30,300)</b>         | -                       |   | <b>(4,149,819)</b>      | 8,741,810               |
| <b>Add /(Subtract) Movements in Other Working Capital Items</b>        |                         |                         | <b>33. Closing Cash &amp; Cash Equivalents</b>  |                         |                         |
| (Increase) / Decrease in Inventories                                   | <b>(165,213)</b>        | (296,339)               |   | 2009<br><u>Rs. '000</u> | 2008<br><u>Rs. '000</u> |
| (Increase) / Decrease in Interest Receivable                           | <b>(927,699)</b>        | 1,025,519               | Foreign Currency Assets   |                         |                         |
| Increase / (Decrease) in Miscellaneous Liabilities                     | <b>(686,675)</b>        | (26,755,479)            | Cash Balances with Other Foreign Banks  | <b>147,871,157</b>      | 167,338,807             |
| Increase / (Decrease) in Interest Payable                              | <b>247,220</b>          | (141,667)               | <b>Closing Cash &amp; Cash Equivalents</b>  | <b>147,871,157</b>      | 167,338,807             |
| Increase / (Decrease) in Other Receivable                              | <b>67,373</b>           | 46,997                  |   |                         |                         |
| <b>Add /(Subtract) Investing and Financing Activities</b>              |                         |                         |   |                         |                         |
| Net Unrealised Market Value Changes                                    | <b>4,177,107</b>        | (2,211,883)             |   |                         |                         |
| <b>Net Cash Flow From</b>  |                         |                         |   |                         |                         |
| <b>Operating Activities</b>  | <b>23,738,631</b>       | 8,940,018               |   |                         |                         |

**34. Concentrations of Funding**

The Bank's significant end-of-year concentrations of funding were as follows.

|   | <b>2009<br/>Total</b> | <b>Sri Lanka<br/>Government</b> | <b>Sri Lanka<br/>Public</b> | <b>Sri Lanka<br/>Commercial<br/>Banks</b> | <b>Supranational<br/>Financial<br/>Institutions</b> | <b>Other</b>      |
|---|-----------------------|---------------------------------|-----------------------------|---|---|-------------------|
| <b>As at 31 December, 2009</b>                      | <b>Rs. '000</b>       | <b>Rs. '000</b>                 | <b>Rs. '000</b>             | <b>Rs. '000</b>                           | <b>Rs. '000</b>                                     | <b>Rs. '000</b>   |
| <b>Foreign Currency Financial Liabilities</b>       |                       |                                 |                             |   |   |                   |
| Amount Payable to Banks and Financial Institutions  | 18,068,841            | -                               | -                           | -   | 202,565   | 17,866,276        |
| Amount Payable to Asian Clearing Union              | 29,836,531            | -                               | -                           | -   | 29,836,531  | -                 |
| IMF Related Liabilities                             | 218,171,021           | -                               | -                           | -   | 218,171,021   | -                 |
| Other Foreign Payables                              | 5,008,035             | -                               | -                           | 1,842,775                                 | 3,165,261   | -                 |
| <b>Total Foreign Currency Financial Liabilities</b> | <b>271,084,428</b>    | <b>-</b>                        | <b>-</b>                    | <b>1,842,775</b>                          | <b>251,375,378</b>                                  | <b>17,866,276</b> |
| <b>Local Currency Financial Liabilities</b>         |                       |                                 |                             |   |   |                   |
| Deposits by Banks and Financial Institutions        | 86,085,866            | -                               | -                           | 86,082,390                                | -   | 3,476             |
| Balances with Government and Government Entities    | 2,347,709             | 2,347,107                       | 601                         | -   | -   | -                 |
| Domestic Securities Issued by CBSL                  | 78,022,645            | -                               | -                           | 78,022,645                                | -   | -                 |
| Securities Sold Under Agreements to Repurchase      | 6,000,000             | -                               | -                           | 6,000,000                                 | -   | -                 |
| Balances with Employee Benefits Plan                | 1,050,255             | -                               | -                           | -   | -   | 1,050,255         |
| Other Payables                                      | 25,981,654            | 68,967                          | -                           | 182,000                                   | -   | 25,730,687        |
| <b>Total Local Currency Financial Liabilities</b>   | <b>199,488,129</b>    | <b>2,416,074</b>                | <b>601</b>                  | <b>170,287,035</b>                        | <b>-</b>  | <b>26,784,418</b> |
| <b>Total Financial Liabilities</b>                  | <b>470,572,557</b>    | <b>2,416,074</b>                | <b>601</b>                  | <b>172,129,810</b>                        | <b>251,375,378</b>                                  | <b>44,650,694</b> |
| <b>Other Liabilities</b>                            |                       |                                 |                             |   |   |                   |
| Currency in Circulation                             | 217,429,835           | -                               | 217,429,835                 | -   | -   | -                 |
| Deferred Grants                                     | 567                   | -                               | -                           | -   | -   | 567               |
| Miscellaneous Liabilities and Accruals              | 66,895                | 17,552                          | -                           | -   | -   | 49,343            |
| <b>Total Other Liabilities</b>                      | <b>217,497,297</b>    | <b>17,552</b>                   | <b>217,429,835</b>          | <b>-</b>                                  | <b>-</b>  | <b>49,910</b>     |
| <b>Total Liabilities</b>                            | <b>688,069,854</b>    | <b>2,433,627</b>                | <b>217,430,436</b>          | <b>172,129,810</b>                        | <b>251,375,378</b>                                  | <b>44,700,604</b> |

Comparative figures as at 31 December 2008 were as follows.

| As at 31 December, 2008   | 2008<br>Total      | Sri Lanka<br>Government | Sri Lanka<br>Public | Sri Lanka<br>Commercial<br>Banks | Supranational<br>Financial<br>Institutions | Other            |
|---|--------------------|-------------------------|---------------------|----------------------------------|--|------------------|
|   | Rs. '000           | Rs. '000                | Rs. '000            | Rs. '000                         | Rs. '000                                   | Rs. '000         |
| <b>Foreign Currency Financial Liabilities</b>   |                    |                         |                     |                                  |  |                  |
| Amount Payable to Banks and Financial Institutions  | 336,091            | -                       | -                   | -                                | 333,703                                    | 2,388            |
| Amount Payable to Asian Clearing Union  | 91,354,909         | -                       | -                   | -                                | 91,354,909                                 | -                |
| IMF Related Liabilities   | 95,133,658         | -                       | -                   | -                                | 95,133,658                                 | -                |
| Other Foreign Payables  | 1,517,077          | -                       | -                   | 1,453,322                        | 63,755                                     | -                |
| <b>Total Foreign Currency Financial Liabilities</b>   | <b>188,341,735</b> | <b>-</b>                | <b>-</b>            | <b>1,453,322</b>                 | <b>186,886,025</b>                         | <b>2,388</b>     |
| <b>Local Currency Financial Liabilities</b>   |                    |                         |                     |                                  |  |                  |
| Securities Sold Under Agreements to Repurchase Balances with Government and Government Entities | 13,743,000         | 13,743,000              | -                   | -                                | -  | -                |
| Deposits by Banks and Financial Institutions  | 1,245,624          | 1,244,977               | 647                 | -                                | -  | 432,585          |
| Balances with Employee Benefits Plan  | 82,311,214         | -                       | -                   | 82,308,288                       | -  | 2,926            |
| Other Payables  | 1,155,061          | -                       | -                   | -                                | -  | 1,155,061        |
|   | 1,664,352          | 242,765                 | -                   | -                                | -  | 1,421,587        |
| <b>Total Local Currency Financial Liabilities</b>   | <b>100,119,251</b> | <b>15,230,742</b>       | <b>647</b>          | <b>82,308,288</b>                | <b>-</b>                                   | <b>3,012,159</b> |
| <b>Total Financial Liabilities</b>  | <b>288,460,986</b> | <b>15,230,742</b>       | <b>647</b>          | <b>83,761,610</b>                | <b>186,886,025</b>                         | <b>3,014,548</b> |
| <b>Other Liabilities</b>  |                    |                         |                     |                                  |  |                  |
| Currency in Circulation   | 186,098,914        | -                       | 186,098,914         | -                                | -  | -                |
| Pension and Other Post Employment Benefit Plans   | 1,026,698          | -                       | -                   | -                                | -  | 1,026,698        |
| Miscellaneous Liabilities and Accruals  | 531,960            | -                       | -                   | -                                | -  | 531,960          |
| <b>Total Other Liabilities</b>  | <b>187,657,572</b> | <b>-</b>                | <b>186,098,914</b>  | <b>-</b>                         | <b>-</b>                                   | <b>1,558,657</b> |
| <b>Total Liabilities</b>  | <b>476,118,558</b> | <b>15,230,742</b>       | <b>186,099,561</b>  | <b>83,761,610</b>                | <b>186,886,025</b>                         | <b>4,573,205</b> |

### 35. Risk Management

As the monetary authority of the country, the Central Bank's activities are policy oriented. In the course of carrying out its functions, the Bank is faced with financial risks, operational risks as well as reputational risks. The Bank's management seeks to ensure that strong and effective risk management

and control systems are in place for assessing, monitoring and managing risk exposure.

The Monetary Board is ultimately responsible for identifying and controlling risks. The Board has delegated this task to several committees and units/departments to ensure effective management and controlling of risk takes place.

The high level Risk Management Committee, chaired by the Governor comprises all Deputy Governors, Assistant Governors and heads of key departments involved in the risk management function. The Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible to ensure that mechanisms are in place to identify potential risks and to take appropriate actions to mitigate such risks. The Committee also seeks to ensure that all necessary internal controls are in place and the risks related to the automated systems used by the Bank, such as the Real-Time Gross Settlement System (RTGS), the Scripless Securities Settlement System (SSSS), the General Ledger System and the Treasury Dealing Room Management System (TDRMS) are controlled.

The main financial risks to which the Central Bank is exposed to are credit risk, foreign exchange risk and interest rate risk. A significant proportion of these risks arise from the management of foreign reserves of the Bank. The International Operations Department (IOD) of the Bank manages the foreign currency portfolio. The Middle Office of the IOD is responsible for the monitoring and management of financial risks relating to the banks' foreign assets portfolio.

The Foreign Reserves Management Committee appointed by the Monetary Board has the responsibility for ensuring that the foreign reserves management function is carried out effectively and efficiently. All policy measures including those in relation to risk management is considered by the Committee and recommended to the Monetary Board for adoption. A comprehensive set of guidelines incorporating risk mitigation policies have been issued to the dealers involved in the reserves management function.

A Counter party Credit Risk Management System is used by the IOD to manage the credit risk of the foreign assets portfolio based on the credit ratings of the investments and the counter parties. Interest rate risk or the exposure of the Bank's foreign assets portfolio to movements in the interest rate is managed through the appropriate adjustments of the duration of the portfolio. The foreign exchange risk or the capital loss as a consequence of fluctuations in the exchange rates is managed mainly through diversification of investment currencies. In the management of foreign reserves, minimizing liquidity risk is the prime consideration in order to maintain an effective foreign exchange intervention capability. Policies for managing the credit, interest rate, foreign exchange and liquidity risks are outlined in sections 35.1, 35.2, 35.3 & 35.4 respectively.

The internal controls and the risk management processes are audited annually by the Management Audit Department (MAD) of the Bank. It examines the adequacy of the procedures and the Bank's compliance with the procedures.

All departments are subject to periodic internal audit review. The MAD reports directly to the Governor and reports its findings and recommendations to the Audit Committee.

The Audit Committee chaired by a Monetary Board member, oversees the auditing arrangements by the MAD as well as the external auditors. The Committee reviews the internal audit function and has direct access to the external auditor. The primary functions of the Audit Committee is to advice and assist the Monetary Board in managing an internationally acceptable financial reporting system, in order to provide accurate, appropriate and timely information to the general public. The Committee reports to the Monetary Board on its activities on a regular basis.

### 35.1 Credit Risk

(a) The Bank's significant end-of-year concentrations of credit exposure by geographical area (based on the entity's country of ownership) were as follows:

#### Concentrations of Credit Exposure in Geographical area

|                                      | 2009<br>Rs. '000   | 2008<br>Rs. '000   |
|--------------------------------------|--------------------|--------------------|
| Sri Lanka                            | 120,604,925        | 259,328,320        |
| USA                                  | 170,269,297        | 88,686,431         |
| Japan                                | 15,189,710         | 706,828            |
| Britain                              | 70,101,508         | 47,229,703         |
| Europe                               | 102,520,720        | 72,914,932         |
| Supranational Financial Institutions | 170,433,627        | 88,850,454         |
| Other                                | 69,913,170         | 15,296,937         |
| <b>Total Financial Assets</b>        | <b>719,032,957</b> | <b>573,013,605</b> |

#### (b) Concentrations of Credit Exposure

The Bank's significant end-of-year concentrations of credit exposure by industry type were as follows;

|  | 2009<br>Rs. '000   | 2008<br>Rs. '000   |
|--|--------------------|--------------------|
| Sri Lanka Government                     | 422,398,857        | 281,740,197        |
| Supranational Financial Institutions     | 170,433,627        | 88,850,454         |
| Foreign Banks and Financial Institutions | 124,737,773        | 200,437,986        |
| Other                                    | 1,462,700          | 1,984,968          |
| <b>Total Financial Assets</b>            | <b>719,032,957</b> | <b>573,013,605</b> |

#### (c) Credit Exposure by Credit Rating

The following table presents the credit ratings of respective financial assets or issuers, based on the ratings of Standard and Poor's, Fitch Ratings and Moody's ratings. Under Standard & Poor's ratings and Fitch Ratings, AAA is the highest quality rating possible and indicates the lowest

expectations of credit risk. It is assigned only in the case of exceptionally strong capacity for timely payment of financial commitment. **AA** is very high quality grade, indicating very low expectation of credit risk, and **A** is an upper medium grade, indicating a low expectation of credit risk; **BBB** is the lowest investment grade rating, indicating that there is currently a low expectation of credit risk and exhibits

adequate protection parameters, ratings lower than **AAA** can be modified by + or – signs to indicate relative standing within the major categories. **NR** indicates Standard and Poor's, Moody's or Fitch have not rated the entity.

Aaa\* denotes rating of Moody

### Credit Exposure by Credit Rating.

|   | <b>Credit Rating</b> | <b>2009<br/>Rs. '000</b> | <b>% 2009<br/>Financial Assets</b> | <b>2008<br/>Rs. '000</b> | <b>% 2008<br/>Financial Assets</b> |
|---|----------------------|--------------------------|------------------------------------|--------------------------|------------------------------------|
| <b>Foreign Currency Financial Assets</b>  |                      |                          |                                    |                          |                                    |
| <b>Cash &amp; Cash Equivalents</b>  |                      |                          |                                    |                          |                                    |
| Federal Reserve Bank – NY/Reserve Bank of Australia/ Bank for International Settlements/Bank of Japan   |                      |                          |                                    |                          |                                    |
|   |                      | 80,272,413               | 11%                                | 90,785,318               | 16%                                |
|   | <b>AAA</b>           | 44,286,854               | 6%                                 | 51,512,175               | 9%                                 |
|   | <b>AA</b>            | 8,075,290                | 1%                                 | 644                      | 0%                                 |
|   | <b>AA-</b>           | 11,210,371               | 2%                                 | 210,637                  | 0%                                 |
|   | <b>A+</b>            | 520,105                  | 0%                                 | 16,326                   | 0%                                 |
|   | <b>A</b>             | -                        | -                                  | 874,189                  | 0%                                 |
|   | <b>NR</b>            | 3,506,124                | 0%                                 | 23,939,518               | 4%                                 |
|   |                      | <b>147,871,157</b>       | <b>21%</b>                         | <b>167,338,807</b>       | <b>29%</b>                         |
| <b>Foreign Currency Trading / Available for Sale Investments</b>  |                      |                          |                                    |                          |                                    |
| Bank for International Settlements/ Federal Reserve Bank – NY/ Reserve Bank of Australia/ Bank of Japan |                      |                          |                                    |                          |                                    |
|   |                      | 8,447,892                | 1%                                 | 579,885                  | 0%                                 |
|   | <b>AAA</b>           | 95,928,452               | 13%                                | 77,946,710               | 14%                                |
|   | <b>AA+</b>           | 12,237,966               | 2%                                 | 0                        | 0%                                 |
|   | <b>AA</b>            | 7,182,081                | 1%                                 | 0                        | 0%                                 |
|   | <b>A+</b>            | 2,288,878                | 0%                                 | 6,244,328                | 1%                                 |
|   | <b>A</b>             | 1,806,969                | 0%                                 |                          |                                    |
|   | <b>A-</b>            | 3,846,837                | 1%                                 |                          |                                    |
|   | <b>B-</b>            | 1,676,346                | 0%                                 |                          |                                    |
|   | <b>NR*</b>           | 238,202,355              | 34%                                | 7,344,237                | 1%                                 |
|   |                      | <b>371,617,775</b>       | <b>52%</b>                         | <b>92,115,159</b>        | <b>16%</b>                         |
| <b>IMF Related Assets</b>   |                      |                          |                                    |                          |                                    |
|   | <b>AAA</b>           | <b>76,509,781</b>        | <b>11%</b>                         | <b>72,399,875</b>        | <b>13%</b>                         |
| <b>Other Foreign Receivables</b>  |                      |                          |                                    |                          |                                    |
| Bank for International Settlements/ Federal Reserve Bank – NY/ Reserve Bank of Australia/ Bank of Japan |                      |                          |                                    |                          |                                    |
|   |                      | 11,278                   | 0%                                 | 3,621                    | 0%                                 |
|   | <b>AAA</b>           | 515,010                  | 0%                                 | 727,588                  | 0%                                 |
|   | <b>AA</b>            | 1,254                    | 0%                                 | 3                        | 0%                                 |
|   | <b>AA-</b>           | 5,725                    | 0%                                 | 652,063                  | 0%                                 |
|   | <b>A</b>             |                          |                                    | 2,542                    | 0%                                 |
|   | <b>NR</b>            | 1,896,053                | 1%                                 | 42,081                   | 0%                                 |
|   |                      | <b>2,429,319</b>         | <b>1%</b>                          | <b>1,427,899</b>         | <b>0%</b>                          |
| <b>Total Foreign Currency Financial Assets</b>  |                      |                          |                                    |                          |                                    |
|   |                      | <b>598,428,032</b>       | <b>83%</b>                         | <b>333,281,740</b>       | <b>58%</b>                         |
| <b>Local Currency Financial Assets</b>  |                      |                          |                                    |                          |                                    |
| Sri Lanka Govt. Securities  |                      |                          |                                    |                          |                                    |
|   | <b>B</b>             | 43,450,557               | 7%                                 | 159,771,674              | 30%                                |
| Loans to Government   |                      |                          |                                    |                          |                                    |
|   | <b>B</b>             | 73,880,500               | 10%                                | 76,307,700               | 12%                                |

|  |       |                    |             |                    |             |
|--|-------|--------------------|-------------|--------------------|-------------|
| Loans to Other Institutions  | NR    | 1,136,596          | 0%          | 1,577,301          | 0%          |
| Other Local Receivables  | NR    | 595,444            | 0%          | 659,770            | 0%          |
| Investments in Financial & Other Institutions  | NR    | 43,855             | 0%          | 50,729             | 0%          |
| Other Assets   | B     | 1,497,973          | 0%          | 1,364,690          | 0%          |
| <b>Total Local Currency Financial Assets</b>   |       | <b>120,604,925</b> | <b>17%</b>  | <b>239,731,864</b> | <b>42%</b>  |
| <b>Total Financial Assets</b>  |       | <b>719,032,957</b> | <b>100%</b> | <b>573,013,604</b> | <b>100%</b> |
| <b>Summary by Major Credit Category</b>  |       |                    |             |                    |             |
| <b>Foreign Currency Financial Assets</b>   |       |                    |             |                    |             |
| Bank for International Settlements /Federal Reserve Bank-NY/ Reserve Bank Australia/ |       |                    |             |                    |             |
| Bank of Japan  |       | 88,731,583         | 12%         | 91,368,824         | 16%         |
| IMF Related Assets   |       | 76,509,781         | 11%         | 72,399,875         | 13%         |
|  | AAA   | 140,730,317        | 19%         | 130,186,472        | 23%         |
|  | AA+/- | 38,712,686         | 5%          | 863,349            | 0%          |
|  | A+/-  | 8,462,789          | 1%          | 7,137,386          | 1%          |
|  | B-    | 1,676,346          | 0%          |                    |             |
|  | NR    | 243,604,531        | 34%         | 31,325,835         | 5%          |
| <b>Total Foreign Currency Financial Assets</b>                                       |       | <b>598,428,032</b> | <b>83%</b>  | <b>333,281,741</b> | <b>58%</b>  |
| <b>Local Currency Financial Assets</b>   |       |                    |             |                    |             |
|  | B/BB- | 119,079,031        | 17%         | 237,444,065        | 41%         |
|  | NR    | 1,525,895          | 0%          | 2,287,800          | 1%          |
| <b>Total Local Currency Financial Assets</b>   |       | <b>120,604,925</b> | <b>17%</b>  | <b>239,731,865</b> | <b>42%</b>  |
| <b>Total Financial Assets</b>  |       | <b>719,032,957</b> | <b>100%</b> | <b>573,013,606</b> | <b>100%</b> |

\* The NR balance of 238,202,355 includes bonds issued by governments such as United Kingdom, United States, Australia, Canada, Germany, France, and Japan etc.

## 35.2 Interest Rate Risk

### (a) Foreign Currency Interest Rate Sensitivity

Interest rate risk is the risk of loss arising from the changes in interest rates.

- (i). The interest rate sensitivity of the Fixed Income Securities portfolio measured by the potential loss incurred due to a rise in interest rate by 10 basis points is a risk measure used by the Bank. Sensitivity of the risk exposure of the segmented Fixed Income Securities Portfolio is given below.

Sensitivity Analysis of the segmented Fixed Income Securities portfolio:

| Portfolio Segment  | Potential Loss (US\$ mn) |      |
|--------------------|--------------------------|------|
|                    | 2009                     | 2008 |
| Trading            | 2.59                     | 1.39 |
| Available for Sale | 6.24                     | 1.39 |
| Total              | 8.83                     | 2.78 |

- (ii). The Middle Office of IOD manages the interest rate risk of the foreign assets portfolio by employing the following strategies.

While the interest rate sensitivity measures the effect of a change in the interest rates on the foreign assets portfolio, CBSL uses Modified Duration (MD) as a measurement

of interest rate risk which considers interest rates as well as the duration of an investment. The MD measures the change in price of a security for a given change in the interest rates (yield). A higher MD indicates a higher risk. Hence, the Bank sets an appropriate MD from time to time considering the developments in the financial markets, portfolio characteristics and the risk appetite of the Bank. As a general practice, the upper limit for foreign exchange reserve holdings of Central Banks is specified around 2.5(overall), while it could vary downward depending on the market outlook and risk appetite of the Central Bank. By maintaining the MD within the upper limits set by the Bank, the interest rate risk and the duration risk of the foreign asset portfolio is controlled. The MDs of the foreign assets portfolio, as compared with the upper limits are tabulated below.

| Investment Segment                       | Modified Duration |                  | Upper Limit |
|--|-------------------|------------------|-------------|
|  | As at 31/12/2009  | As at 31/12/2008 |             |
| Money Market (Fixed & call deposits)     | 0.03              | 0.04             | 0.25        |
| Capital Market (Fixed Income Securities) | 2.87              | 3.41             | 5.0         |
| Overall                                  | 1.84              | 1.76             | 2.5         |



Since the modified duration does not account for large changes in prices another measure of interest rate risk of the foreign reserves portfolio used for risk management is convexity. Convexity measures the extent of deviation in bond price-yield curve from a straight line representing duration. It allows improving the duration approximation for bond price changes.

Convexity of the segmented Fixed Income Securities portfolio:

| Portfolio Segment  | 2009 | 2008 |
|--------------------|------|------|
| Trading            | 0.50 | 0.18 |
| Available for Sale | 0.11 | 0.23 |
| Total              | 0.17 | 0.20 |

### (b) Local Currency Interest Rate Sensitivity

The local Treasury bills portfolio is recorded in the Statement of Financial Position of the CBSL at amortized cost as it represents loans provided to the Government of Sri Lanka. This portfolio is not an investment portfolio, as the Bank does not purchase Treasury bills with the intention

of earning an interest income. The bank purchases or sells Treasury bills to inject rupee liquidity into the domestic market or to absorb liquidity from the market in the course of carrying out its monetary policy operations in relation to one of its core objectives, namely maintaining economic and price stability. Hence, the volume of Treasury bills in the Bank's portfolio is determined by its monetary policy operations. In addition, the basic interest rates in the rupee market, namely, the Repo rate and the Reverse Repo rate are policy rates determined by the Bank in the course of implementing its monetary policy. Moreover, the Bank's actions in injecting rupee liquidity or absorbing liquidity from the market have a significant impact on general rupee market interest rates. Thus, changes in the interest income earned from the Treasury bill portfolio, which arise from changes in the volume of the Bank's Treasury bill portfolio, as well as changes in interest rates, are primarily a consequence of the Bank's monetary policy actions, rather than due to investment decisions. Therefore, the Bank does not consider interest rate sensitivities arising from local currency assets.

### (c) Assets and liabilities will mature or re-price within the following periods.

| Foreign Currency Interest Rate Sensitivity Gap:                                    | Weighted Ave. Int. Rate % | 2009 Total Rs. '000 | <= 6 Months Rs. '000 | 6 - 12 Months Rs. '000 | 1 - 2 Years Rs. '000 | 2 - 5 Years Rs. '000 | > 5 Years Rs. '000 |
|--|---------------------------|---------------------|----------------------|------------------------|----------------------|----------------------|--------------------|
| <b>Interest Sensitive Foreign Currency Financial Assets</b>                        |                           |                     |                      |                        |                      |                      |                    |
| Cash & Cash Equivalents  | 1.07                      | 147,871,157         | 147,871,157          | -                      | -                    | -                    | -                  |
| Securities at Fair Value through Profit or Loss and Available for Sale Investments | 2.24                      | 371,617,775         | 28,448,309           | 19,141,034             | 111,328,788          | 149,534,851          | 63,164,793         |
| IMF Related Assets   | 0.24                      | 10,836,493          | 10,836,493           | -                      | -                    | -                    | -                  |
| <b>Total Interest Sensitive Foreign Currency Financial Assets</b>                  |                           | <b>530,325,425</b>  | <b>187,155,958</b>   | <b>19,141,034</b>      | <b>111,328,788</b>   | <b>149,534,851</b>   | <b>63,164,793</b>  |
| <b>Non-Interest Sensitive Foreign Currency Financial Assets</b>                    |                           |                     |                      |                        |                      |                      |                    |
| IMF Related assets   |                           | 65,673,289          | -                    | -                      | -                    | -                    | 65,673,289         |
| Receivables  |                           | 2,429,319           | 2,429,319            | -                      | -                    | -                    | -                  |
| <b>Total Non-Interest Sensitive Foreign Currency Financial Assets</b>              |                           | <b>68,102,608</b>   | <b>2,429,319</b>     |                        |                      |                      | <b>65,673,289</b>  |
| <b>Total Foreign Currency Financial Assets</b>                                     |                           | <b>598,428,033</b>  | <b>189,585,277</b>   | <b>19,141,034</b>      | <b>111,328,788</b>   | <b>149,534,851</b>   | <b>128,838,082</b> |
| <b>Interest Sensitive Foreign Currency Financial Liabilities</b>                   |                           |                     |                      |                        |                      |                      |                    |
| IMF Related Liabilities  | 0.08                      | 82,201,426          | 3,301,811            | 685,903                | 1,371,805            | 76,841,907           | -                  |
| Amount Payable to Asian Clearing Union   | 0.14                      | 29,836,531          | 29,836,531           | -                      | -                    | -                    | -                  |
| <b>Total Interest Sensitive Foreign Currency Financial Liabilities</b>             |                           | <b>112,037,957</b>  | <b>33,138,342</b>    | <b>685,903</b>         | <b>1,371,805</b>     | <b>76,841,907</b>    |                    |
| <b>Non-Interest Sensitive Foreign Currency Financial Liabilities</b>               |                           |                     |                      |                        |                      |                      |                    |
| Amounts payable to ACU   |                           | 17,870,207          | 17,870,207           | -                      | -                    | -                    | -                  |
| IMF related liabilities  |                           | 136,168,229         | 198,634              | -                      | -                    | -                    | 135,969,595        |
| Commercial bank capital in foreign currency  |                           | 1,842,775           | -                    | -                      | -                    | -                    | 1,842,775          |
| Other foreign liabilities  |                           | 3,165,261           | 3,165,261            | -                      | -                    | -                    | -                  |
| <b>Total Non-Interest Sensitive Foreign Currency Financial Liabilities</b>         |                           | <b>159,046,471</b>  | <b>21,234,102</b>    |                        |                      |                      | <b>137,812,369</b> |
| <b>Total Foreign Currency Financial Liabilities</b>                                |                           | <b>271,084,428</b>  | <b>54,372,444</b>    | <b>685,903</b>         | <b>1,371,805</b>     | <b>76,841,907</b>    | <b>137,812,369</b> |
| <b>Foreign Currency Interest Rate Sensitivity Gap</b>                              |                           | <b>418,287,467</b>  | <b>154,017,616</b>   | <b>18,455,132</b>      | <b>109,956,983</b>   | <b>72,692,944</b>    | <b>63,164,793</b>  |
| <b>Local Currency Interest Rate Sensitivity Gap:</b>                               |                           |                     |                      |                        |                      |                      |                    |
| <b>Interest Sensitive Local Currency Financial Assets</b>                          |                           |                     |                      |                        |                      |                      |                    |
| Investment portfolio-Sri Lanka Government Securities                               | 11.24                     | 43,450,557          | 32,626,178           | 10,824,379             | -                    | -                    | -                  |
| Loans to Other Institutions  | 3.00                      | 1,136,596           | 197,541              | 194,393                | 292,541              | 452,121              | -                  |
| Other assets   | 14.56                     | 1,490,476           | 318,153              | 904,015                | 258,866              | 9,442                | -                  |
| <b>Total Interest Sensitive Local Currency Assets</b>                              |                           | <b>46,077,629</b>   | <b>33,141,872</b>    | <b>11,922,787</b>      | <b>551,407</b>       | <b>461,563</b>       |                    |
| <b>Non Interest Sensitive Local Currency Assets</b>                                |                           |                     |                      |                        |                      |                      |                    |
| Loans to Government  |                           | 73,880,500          | 73,880,500           | -                      | -                    | -                    | -                  |
| Receivables  |                           | 595,444             | 345,444              | -                      | -                    | -                    | 250,000            |
| Investment Securities - Available for Sale   |                           | 43,855              | 732                  | -                      | -                    | -                    | 43,123             |
| Other Assets   |                           | 7,497               | 7,497                | -                      | -                    | -                    | -                  |
| <b>Total Non Interest Sensitive Local Currency Assets</b>                          |                           | <b>74,527,296</b>   | <b>74,234,173</b>    |                        |                      |                      | <b>293,123</b>     |
| <b>Total Local Currency Assets</b>   |                           | <b>120,604,925</b>  | <b>107,376,045</b>   | <b>11,922,787</b>      | <b>551,407</b>       | <b>461,563</b>       | <b>293,123</b>     |
| <b>Interest Sensitive Local Currency Financial Liabilities</b>                     |                           |                     |                      |                        |                      |                      |                    |
| Securities Sold Under Agreements to Repurchase                                     | 8.65                      | 6,000,000           | 6,000,000            | -                      | -                    | -                    | -                  |
| Domestic Securities Issued by CBSL   | 8.59                      | 78,022,645          | 78,022,645           | -                      | -                    | -                    | -                  |
| <b>Total Interest Sensitive Local Currency Financial Liabilities</b>               |                           | <b>84,022,645</b>   | <b>84,022,645</b>    |                        |                      |                      |                    |

|  |  |                     |                     |                   |                |                |   |
|--|--|---------------------|---------------------|-------------------|----------------|----------------|---|
| <b>Non Interest Sensitive Local Currency Liabilities</b>       |  |                     |                     |                   |                |                |   |
| Balance with Banks and Financial Institutions                  |  | 86,085,866          | 86,085,866          | -                 | -              | -              | - |
| Balances with Government and Government Entities               |  | 2,347,709           | 2,347,709           | -                 | -              | -              | - |
| Balances with Employee Benefit Plans                           |  | 1,050,255           | 1,050,255           | -                 | -              | -              | - |
| Other Deposits & payables                                      |  | 25,981,654          | 25,981,654          | -                 | -              | -              | - |
| <b>Total Non Interest Sensitive Local Currency Liabilities</b> |  | <b>115,465,484</b>  | <b>115,465,484</b>  | -                 | -              | -              | - |
| <b>Total Local Currency Liabilities</b>                        |  | <b>199,488,129</b>  | <b>199,488,129</b>  | -                 | -              | -              | - |
| <b>Local Currency Interest Rate Sensitivity Gap</b>            |  | <b>(37,945,017)</b> | <b>(50,880,774)</b> | <b>11,922,787</b> | <b>551,407</b> | <b>461,563</b> | - |

Comparative figures as at 31 December 2008 were as follows.

|  |       |                    |                    |                    |                   |                   |                   |
|--|-------|--------------------|--------------------|--------------------|-------------------|-------------------|-------------------|
| <b>Foreign Currency Interest Rate Sensitivity Gap:</b>                             |       |                    |                    |                    |                   |                   |                   |
| <b>Interest Sensitive Foreign Currency Financial Assets</b>                        |       |                    |                    |                    |                   |                   |                   |
| Cash & Cash Equivalents  | 0.60  | 167,338,807        | 167,338,807        | -                  | -                 | -                 | -                 |
| Securities at Fair Value through Profit or Loss and Available for Sale Investments | 3.24  | 92,115,159         | 1,040,929          | 805,633            | 35,318,189        | 24,578,371        | 30,372,038        |
| IMF Related Assets   | 2.47  | 8,560,403          | 8,560,403          | -                  | -                 | -                 | -                 |
| <b>Total Interest Sensitive Foreign Currency Financial Assets</b>                  |       | <b>268,014,369</b> | <b>176,940,139</b> | <b>805,633</b>     | <b>35,318,189</b> | <b>24,578,371</b> | <b>30,372,038</b> |
| <b>Non-Interest Sensitive Foreign Currency Financial Assets</b>                    |       |                    |                    |                    |                   |                   |                   |
| IMF Related assets   |       | 63,839,472         | -                  | -                  | -                 | -                 | 63,839,472        |
| Receivables  |       | 1,427,899          | 1,427,899          | -                  | -                 | -                 | -                 |
| <b>Total Non-Interest Sensitive Foreign Currency Financial Assets</b>              |       | <b>65,267,371</b>  | <b>1,427,899</b>   | -                  | -                 | -                 | <b>63,839,472</b> |
| <b>Total Foreign Currency Financial Assets</b>                                     |       | <b>333,281,740</b> | <b>178,368,038</b> | <b>805,633</b>     | <b>35,318,189</b> | <b>24,578,371</b> | <b>94,211,510</b> |
| <b>Interest Sensitive Foreign Currency Financial Liabilities</b>                   |       |                    |                    |                    |                   |                   |                   |
| IMF Related Liabilities  | 2.59  | 19,078,598         | 5,771,951          | 5,771,951          | 4,189,660         | 3,345,036         | -                 |
| Amounts Payable to ACU   | 1.79  | 91,354,909         | 91,354,909         | -                  | -                 | -                 | -                 |
| <b>Total Interest sensitive Foreign Currency Financial Liabilities</b>             |       | <b>110,433,507</b> | <b>97,126,860</b>  | <b>5,771,951</b>   | <b>4,189,660</b>  | <b>3,345,036</b>  | -                 |
| <b>Non-Interest Sensitive Foreign Currency Financial Liabilities</b>               |       |                    |                    |                    |                   |                   |                   |
| Amounts payable to ACU   |       | 262,990            | 262,990            | -                  | -                 | -                 | -                 |
| IMF Related Liabilities  |       | 76,055,059         | -                  | -                  | -                 | -                 | 76,055,059        |
| Commercial Banks Capital in foreign Currency                                       |       | 1,453,322          | -                  | -                  | -                 | -                 | 1,453,322         |
| Other Foreign Liabilities  |       | 136,856            | 136,856            | -                  | -                 | -                 | -                 |
| <b>Total Non-Interest Sensitive Foreign Currency Financial Liabilities</b>         |       | <b>77,908,227</b>  | <b>399,846</b>     | -                  | -                 | -                 | <b>77,508,381</b> |
| <b>Total Foreign Currency Financial Liabilities</b>                                |       | <b>188,341,734</b> | <b>97,526,706</b>  | <b>5,771,951</b>   | <b>4,189,660</b>  | <b>3,345,036</b>  | <b>77,508,381</b> |
| <b>Foreign Currency Interest Rate Sensitivity Gap</b>                              |       | <b>157,580,862</b> | <b>79,813,279</b>  | <b>(4,966,318)</b> | <b>31,128,529</b> | <b>21,233,335</b> | <b>30,372,038</b> |
| <b>Local Currency Interest Rate Sensitivity Gap:</b>                               |       |                    |                    |                    |                   |                   |                   |
| <b>Interest Sensitive Local Currency Financial Assets</b>                          |       |                    |                    |                    |                   |                   |                   |
| Investment Portfolio – Sri Lanka Government Securities                             | 18.49 | 142,813,489        | 55,673,224         | 87,140,265         | -                 | -                 | -                 |
| Reverse Repos  | 12.50 | 13,204,000         | 13,204,000         | -                  | -                 | -                 | -                 |
| Loans to Other Institutions  | 3.0   | 1,577,301          | 210,537            | 199,976            | 358,909           | 789,595           | 18,284            |
| Other Assets   | 13.1  | 1,364,690          | 511,512            | 22,346             | 11,163            | -                 | -                 |
| <b>Total Interest Sensitive Local Currency Assets</b>                              |       | <b>158,959,480</b> | <b>69,599,273</b>  | <b>87,362,587</b>  | <b>370,072</b>    | <b>789,595</b>    | <b>18,284</b>     |
| <b>Non Interest Sensitive Local Currency Assets</b>                                |       |                    |                    |                    |                   |                   |                   |
| Interest Receivable on Government Securities                                       |       | 3,754,186          | 2,017,619          | 1,736,567          | -                 | -                 | -                 |
| Loans to Government  |       | 76,307,700         | 76,307,700         | -                  | -                 | -                 | -                 |
| Receivables  |       | 659,770            | 659,770            | -                  | -                 | -                 | -                 |
| Investment in Equity   |       | 50,729             | -                  | -                  | -                 | -                 | 50,729            |
| Other Assets   |       | 13,626,313         | 13,626,313         | -                  | -                 | -                 | -                 |
| <b>Total Non Interest Sensitive Local Currency Assets</b>                          |       | <b>94,398,698</b>  | <b>92,611,402</b>  | <b>1,736,567</b>   | -                 | -                 | <b>50,729</b>     |
| <b>Total Local Currency Assets</b>   |       | <b>253,358,178</b> | <b>162,210,675</b> | <b>89,099,154</b>  | <b>370,072</b>    | <b>789,595</b>    | <b>69,013</b>     |
| <b>Interest Sensitive Local Currency Financial Liabilities</b>                     |       |                    |                    |                    |                   |                   |                   |
| Securities sold Under Agreements to Repurchase                                     | 10.50 | 13,743,000         | 13,743,000         | -                  | -                 | -                 | -                 |
| <b>Total Interest Sensitive Local Currency Financial Liabilities</b>               |       | <b>13,743,000</b>  | <b>13,743,000</b>  | -                  | -                 | -                 | -                 |
| <b>Non Interest Sensitive Local Currency Liabilities</b>                           |       |                    |                    |                    |                   |                   |                   |
| Deposits by Banks and Financial Institutions                                       |       | 82,311,214         | 82,311,214         | -                  | -                 | -                 | -                 |
| Balances with Government and Government Entities                                   |       | 1,245,624          | 1,245,624          | -                  | -                 | -                 | -                 |
| Balances with Employee Benefit Plans   |       | 1,155,061          | 1,155,061          | -                  | -                 | -                 | -                 |
| Other Deposits & Payables  |       | 1,664,353          | 1,664,353          | -                  | -                 | -                 | -                 |
| Other Liabilities  |       | 187,657,572        | 187,657,572        | -                  | -                 | -                 | -                 |
| <b>Total Non Interest Sensitive Local Currency Liabilities</b>                     |       | <b>274,033,824</b> | <b>274,033,824</b> | -                  | -                 | -                 | -                 |
| <b>Total Local Currency Liabilities</b>  |       | <b>287,776,824</b> | <b>287,776,824</b> | -                  | -                 | -                 | -                 |
| <b>Local Currency Interest Rate Sensitivity Gap</b>                                |       | <b>145,216,480</b> | <b>55,856,273</b>  | <b>87,362,587</b>  | <b>370,072</b>    | <b>789,595</b>    | <b>18,284</b>     |

### 35.3 Foreign Currency Risk

Foreign currency risk is the risk of loss arising from changes in exchange rates.

Foreign currency activities result mainly from the Bank's holding of foreign currency assets under its foreign reserves management function. Volatility of the foreign exchange markets may expose the Bank to exchange risk. The Monetary Board and Foreign Reserves Management Committee (FRMC) have set percentage holdings of

different currencies in its International Reserves. In deciding on the currency allocation, public debt repayment requirements are given due consideration. Accordingly, the Bank holds most major currencies such as US Dollars, Sterling Pounds, Australian Dollars, Japanese Yen, and the Euro. Compliance with limits established for foreign currency positions are monitored.

As at 31 December, the CBSL's net exposure to major currencies was as follows.

|  | Currency Denomination     |                   |                   |                                |                      |                   |                                 | Total<br>All<br>Currencies<br>Rs. '000 |
|--|---------------------------|-------------------|-------------------|--------------------------------|----------------------|-------------------|---------------------------------|--|
|  | US<br>Dollars<br>Rs. '000 | Euro<br>Rs. '000  | Yen<br>Rs. '000   | Sterling<br>Pounds<br>Rs. '000 | SDR<br>Rs. '000      | AUD<br>Rs. '000   | Other<br>Currencies<br>Rs. '000 |  |
| <b>As at 31 December 2009</b>  |                           |                   |                   |                                |                      |                   |                                 |  |
| <b>Foreign Currency Financial Assets</b>                               |                           |                   |                   |                                |                      |                   |                                 |  |
| Cash & Cash Equivalents  | 38,674,007                | 40,395,988        | 10,595,236        | 18,494,893                     | -                    | 47,649,480        | (7,938,448)                     | 147,871,157                            |
| Securities at Fair Value through Profit or Loss and Available for Sale |                           |                   |                   |                                |                      |                   |                                 |  |
| Investments  | 195,445,909               | 44,145,531        | 9,203,770         | 73,788,798                     | -                    | 49,033,768        | -                               | 371,617,775                            |
| IMF Related Assets   | -                         | -                 | -                 | -                              | 76,509,781           | -                 | -                               | 76,509,781                             |
| Other Foreign Receivables  | 169                       | 4,607             | -                 | 1,898,236                      | 1,840                | 500,536           | 23,932                          | 2,429,319                              |
| <b>Total Foreign Currency Financial Assets</b>                         | <b>234,120,085</b>        | <b>84,546,126</b> | <b>19,799,006</b> | <b>94,181,927</b>              | <b>76,511,621</b>    | <b>97,183,783</b> | <b>(7,914,516)</b>              | <b>598,428,032</b>                     |
| Proportion   | 39%                       | 14%               | 3%                | 16%                            | 13%                  | 16%               | 0%                              | 100%                                   |
| <b>Foreign Currency Financial Liabilities</b>                          |                           |                   |                   |                                |                      |                   |                                 |  |
| Payables   | 3,325,965                 | 83                | 1,245,353         | 3,691,032                      | 198,634              | 12,773,034        | -                               | 21,234,101                             |
| Amount Payable to Asian Clearing Union                                 | 29,705,557                | 130,975           | -                 | -                              | -                    | -                 | -                               | 29,836,531                             |
| IMF Related Liabilities  | -                         | -                 | -                 | -                              | 218,171,021          | -                 | -                               | 218,171,021                            |
| Other Foreign Liabilities Commercial Banks                             | -                         | -                 | -                 | -                              | -                    | -                 | -                               | -                                      |
| - Capital Deposits in Foreign Currency                                 | 1,842,775                 | -                 | -                 | -                              | -                    | -                 | -                               | 1,842,775                              |
| <b>Total Foreign Currency Financial Liabilities</b>                    | <b>34,874,297</b>         | <b>131,058</b>    | <b>1,245,353</b>  | <b>3,691,032</b>               | <b>218,369,655</b>   | <b>12,773,034</b> | <b>-</b>                        | <b>271,084,428</b>                     |
| Proportion   | 13%                       | 0%                | 0%                | 1%                             | 81%                  | 5%                | 0%                              | 100%                                   |
| <b>Net Foreign Currency Exposure</b>                                   | <b>199,245,788</b>        | <b>84,415,068</b> | <b>18,553,653</b> | <b>90,490,895</b>              | <b>(141,858,034)</b> | <b>84,410,749</b> | <b>(7,914,516)</b>              | <b>327,343,604</b>                     |

Comparative figures as at 31 December 2008 were as follows.

|  | Currency Denomination                   |                   |                             |                               |                     |                                   |                                 | Total<br>All<br>Currencies<br>Rs. '000 |
|--|---|-------------------|-----------------------------|-------------------------------|---------------------|-----------------------------------|---------------------------------|--|
|  | United<br>States<br>Dollars<br>Rs. '000 | Euro<br>Rs. '000  | Japanese<br>Yen<br>Rs. '000 | Sterling<br>Pound<br>Rs. '000 | SDR<br>Rs. '000     | Australian<br>Dollars<br>Rs. '000 | Other<br>Currencies<br>Rs. '000 |  |
| <b>As at 31 December 2008</b>  |   |                   |                             |                               |                     |                                   |                                 |  |
| <b>Foreign Currency Financial Assets</b>                               |   |                   |                             |                               |                     |                                   |                                 |  |
| Cash & Cash Equivalents  | 102,261,905                             | 19,813,147        | 706,828                     | 40,088,541                    | -                   | 3,775,039                         | 693,346                         | 167,338,807                            |
| Securities at Fair Value through Profit or Loss and Available for Sale |   |                   |                             |                               |                     |                                   |                                 |  |
| Investments  | 5,996,334                               | 39,036,431        | -                           | 20,070,370                    | -                   | 27,012,024                        | -                               | 92,115,159                             |
| IMF Related Assets   | -                                       | -                 | -                           | -                             | 72,399,875          | -                                 | -                               | 72,399,875                             |
| Other Foreign Receivables  | 23,293                                  | 1,311,808         | -                           | -                             | 17,564              | -                                 | 75,234                          | 1,427,899                              |
| <b>Total Foreign Currency Financial Assets</b>                         | <b>108,281,533</b>                      | <b>60,161,386</b> | <b>706,828</b>              | <b>60,158,911</b>             | <b>72,417,439</b>   | <b>30,787,063</b>                 | <b>768,580</b>                  | <b>333,281,740</b>                     |
| Proportion   | 32%                                     | 18%               | 0%                          | 18%                           | 22%                 | 9%                                | 0%                              | 100%                                   |
| <b>Foreign Currency Financial Liabilities</b>                          |   |                   |                             |                               |                     |                                   |                                 |  |
| Amount Payable to Banks and Financial Institutions                     | 336,091                                 | -                 | -                           | -                             | -                   | -                                 | -                               | 336,091                                |
| Amount Payable to Asian Clearing Union                                 | 91,354,909                              | -                 | -                           | -                             | -                   | -                                 | -                               | 91,354,909                             |
| IMF Related Liabilities  | -                                       | -                 | -                           | -                             | 95,133,658          | -                                 | -                               | 95,133,658                             |
| Commercial Banks   |   |                   |                             |                               |                     |                                   |                                 |  |
| - Capital Deposits in Foreign Currency                                 | 1,517,077                               | -                 | -                           | -                             | -                   | -                                 | -                               | 1,517,077                              |
| <b>Total Foreign Currency Financial Liabilities</b>                    | <b>93,208,077</b>                       | <b>-</b>          | <b>-</b>                    | <b>-</b>                      | <b>95,133,658</b>   | <b>-</b>                          | <b>-</b>                        | <b>188,341,735</b>                     |
| Proportion   | 49%                                     | 0%                | 0%                          | 0%                            | 51%                 | 0%                                | 0%                              | 100%                                   |
| <b>Net Foreign Currency Exposure</b>                                   | <b>15,073,455</b>                       | <b>60,161,386</b> | <b>706,828</b>              | <b>60,158,912</b>             | <b>(22,716,218)</b> | <b>30,787,063</b>                 | <b>768,580</b>                  | <b>144,940,005</b>                     |

### 35.4 Liquidity Risk

Liquidity risk is the difficulty that an entity will encounter in raising funds at short notice to meet commitments associated with financial instruments. Liquidity risk is also the risk that an entity will have to sell a financial asset quickly at much less than its fair value.

(a) Liquidity is a key consideration in determining the composition of the Bank's foreign currency assets as well. This reflects the potential requirement to liquidate foreign reserves for intervention purposes and to settle other commitments such as public debt and IMF Loan repayments when the need arises. The Bank has adopted the following measures aimed at ensuring quick access to funds:

- Liquid asset ratios based on the liquidity characteristics of securities held.
- Limits on the minimum and maximum proportion of reserves that may be held in one currency.

#### Fair Values & Carrying Amount

|   | Carrying amount    |                 | Fair Value         |                 |
|---|--------------------|-----------------|--------------------|-----------------|
|   | 2009<br>Rs '000    | 2008<br>Rs '000 | 2009<br>Rs '000    | 2008<br>Rs '000 |
| <b>Fair values</b>                                      |                    |                 |                    |                 |
| Cash & Cash Equivalents                                 | 147,871,157        | 167,338,807     | 147,871,157        | 167,338,807     |
| Foreign Currency Trading/ Available for Sale Securities | 371,617,775        | 92,115,159      | 371,617,775        | 92,115,159      |
| IMF Related Assets                                      | 76,509,781         | 72,399,875      | 76,509,781         | 72,399,875      |
| Other Foreign Receivables                               | 2,429,319          | 1,427,899       | 2,429,319          | 1,427,899       |
|   | <b>598,428,032</b> | 333,281,740     | <b>598,428,032</b> | 333,281,740     |
| Sri Lanka Government Securities                         | 43,450,557         | 159,771,674     | 43,450,557         | 159,771,674     |
| Loans to Government                                     | 73,880,500         | 76,307,700      | 73,880,500         | 76,307,700      |
| Loans to other Institutions                             | 1,136,596          | 1,577,301       | 1,136,596          | 1,577,301       |
| Other Local Receivables                                 | 595,444            | 659,770         | 595,444            | 659,770         |
| Investments in Financial & Other Institutions           | 43,855             | 50,729          | 43,855             | 50,729          |
| Other Assets  | 1,497,973          | 1,364,690       | 1,497,973          | 1,364,690       |
| <b>Total Financial Assets</b>                           | <b>719,032,957</b> | 573,013,605     | <b>719,032,957</b> | 573,013,605     |
| Investments in Gold                                     | 84,834,269         | 10,078,754      | 84,834,269         | 10,078,754      |
| Trading Securities Denominated in Gold                  | -                  | 348,678         | -                  | 348,678         |
| <b>Total Foreign Currency Non Financial Assets</b>      | <b>84,834,269</b>  | 10,427,432      | <b>84,834,269</b>  | 10,427,432      |
| <b>Financial liabilities</b>                            |                    |                 |                    |                 |
| Amounts payable to Banks & Financial Institutions       | 18,068,841         | 336,091         | 18,068,841         | 336,091         |
| IMF related liabilities                                 | 218,171,021        | 95,133,658      | 218,171,021        | 95,133,658      |
| Amounts payable to ACU                                  | 29,836,531         | 91,354,909      | 29,836,531         | 91,354,909      |
| Other foreign payables                                  | 5,008,035          | 1,517,077       | 5,008,035          | 1,517,077       |

|  |                    |             |                    |             |
|--|--------------------|-------------|--------------------|-------------|
|  | 271,084,428        | 188,341,735 | 271,084,428        | 188,341,735 |
| Commercial Banks & Other Financial Institutions  | 86,085,866         | 82,311,214  | 86,085,866         | 82,311,214  |
| Balances with Government and Government Entities | 2,347,709          | 1,245,624   | 2,347,709          | 1,245,624   |
| Securities Sold under agreement to repurchase    | 84,022,645         | 13,743,000  | 84,022,645         | 13,743,000  |
| Balances with Employee Benefits Plan             | 1,060,438          | 1,155,061   | 1,060,438          | 1,155,061   |
| Other Payables                                   | 25,981,654         | 1,664,353   | 25,981,654         | 1,664,353   |
| <b>Total Financial Liabilities</b>               | <b>470,582,740</b> | 288,460,986 | <b>470,582,740</b> | 288,460,986 |

(b) In order to reduce the level of liquidity risk arising out of the local currency activities, particularly open market operations, the Bank uses highly liquid marketable instruments such as Treasury Bills & Treasury Bonds as collateral. It manages the daily liquidity position of the banking system by way of infusing into or withdrawal from the system, using instruments such as repo / reverse repo, CBSL securities & USD /LKR SWAPs.

### 36. Pension and Other Post Retirement Benefits

The Bank operates five defined benefit plans, which cover all eligible employees. Under the Employees' Retirement Pension Scheme, employees who joined the Bank prior to 1 January 1998 and complete 10 years of service become eligible. The Pension Scheme is a non-contributory pension scheme where the cost of benefits is wholly borne by the Bank. The Widows' and Orphans' Pension Scheme for male employees and Widowers' and Orphans' Pension Scheme for female employees are open to employees of the Bank who had joined prior to 1 January 1998. Employees eligible under these plans contribute 5% of the monthly basic salary.

The Bank also provides gratuity benefits to employees who have completed five years of service in the Bank and who are not eligible for a monthly pension payment under the Employees' Retirement Pension Scheme. In order to meet this liability, a provision is carried forward in the Statement of Financial Position, equivalent to the liability calculated using actuarial valuation.

The Bank has a Post Employment Medical Benefit Scheme, which provides reimbursement of certain medical expenses incurred by retired employees on account of themselves or their spouses and by widows/widowers.

The Bank employed an Independent Actuary M/S K. A. Pandit, Consultant & Actuary (Bombay) to carry out an actuarial valuation of the defined benefit obligations and the current service costs attributable to the Employees' Retirement Pension Scheme Widows' and Orphans' Pension Scheme and Widowers' and Orphans' Pension Scheme, Gratuity Scheme and Medical Benefit Scheme during the year.

The following table summarizes the components of net benefit expense charged to the income statement, by the Bank in respect of current service cost, interest cost, net of expected return on plan assets, Actuarial gain/(losses) & transitional adjustments and the defined benefit obligations as per the actuarial valuation for respective plans.

The total fair value of plan assets of Rs.23, 331,568 exceeds the total present value of all benefit obligations of Rs.22, 484,718 at the end of reporting period resulting in a surplus of Rs.846, 850 .At the previous reporting period the total present value of all benefit obligations exceeded the fair value of plan assets representing a funding gap of Rs.2, 031,226.

## 2009

|   | Employee Retirement Pension Scheme | Widows' and Orphans' Pension Scheme | Widowers' and Orphans' Pension Scheme | Gratuity Scheme | Medical Benefit Scheme | Total             |
|---|------------------------------------|-------------------------------------|---------------------------------------|-----------------|------------------------|-------------------|
|   | Rs. '000                           | Rs. '000                            | Rs. '000                              | Rs. '000        | Rs. '000               | Rs. '000          |
| <b>Benefit Liability/ (Asset)</b>                       |                                    |                                     |                                       |                 |                        |                   |
| Present Value of Benefit Obligation                     | 18,511,015                         | 2,523,147                           | 473,914                               | 48,507          | 928,135                | 22,484,718        |
| Fair Value of Plan Assets                               | (16,580,964)                       | (4,274,381)                         | (1,272,455)                           | (45,669)        | (1,158,099)            | (23,331,568)      |
| Unrecognised net Actuarial Gains/(Losses)               | (1,447,688)                        | 1,238,342                           | 644,226                               | 3,781           | 114,714                | 553,374           |
| Unrecognised Transitional Liability                     | -                                  | -                                   | -                                     | -               | -                      | -                 |
| <b>Benefit Liability / (Asset) Non-Current</b>          | <b>482,363</b>                     | <b>(512,892)</b>                    | <b>(154,316)</b>                      | <b>6,618</b>    | <b>(115,250)</b>       | <b>(293,476)</b>  |
| <b>Movement in the Benefit (Asset) / Liability</b>      |                                    |                                     |                                       |                 |                        |                   |
| At 1 January 2009                                       | 1,380,171                          | (207,397)                           | (55,998)                              | (4,051)         | (86,028)               | 1,026,697         |
| Benefit Expense   | 316,319                            | 39,368                              | 23,848                                | 10,669          | (29,222)               | 360,983           |
| Contribution Paid                                       | (1,214,127)                        | (344,863)                           | (122,165)                             | -               | -                      | (1,681,156)       |
| <b>At 31 December 2009 - Non-Current</b>                | <b>482,363</b>                     | <b>(512,892)</b>                    | <b>(154,316)</b>                      | <b>6,618</b>    | <b>(115,250)</b>       | <b>(293,476)</b>  |
| <b>Benefit Expense</b>                                  |                                    |                                     |                                       |                 |                        |                   |
| Interest Cost on Benefit Obligation                     | 1,584,768                          | 364,307                             | 111,064                               | 4,319           | 86,616                 | 2,151,074         |
| Expected Return on Plan Assets                          | (1,392,879)                        | (340,724)                           | (98,679)                              | (5,055)         | (110,615)              | (1,947,952)       |
| Net Actuarial (Gain)/Loss Recognized during the year    | -                                  | 15,785                              | 11,463                                | -               | (8,418)                | 18,830            |
| Transitional Adjustment                                 | -                                  | -                                   | -                                     | -               | -                      | -                 |
| Net current Service Cost                                | 124,430                            | -                                   | -                                     | 11,405          | 3,195                  | 139,030           |
| Past Service Cost                                       | -                                  | -                                   | -                                     | -               | -                      | -                 |
| <b>Net benefit expense</b>                              | <b>316,319</b>                     | <b>39,368</b>                       | <b>23,848</b>                         | <b>10,669</b>   | <b>(29,222)</b>        | <b>360,983</b>    |
| <b>Actual return on plan assets</b>                     | <b>2,339,910</b>                   | <b>674,626</b>                      | <b>174,043</b>                        | <b>4,655</b>    | <b>133,656</b>         | <b>3,326,889</b>  |
| <b>Changes in Fair Value of Plan Assets</b>             |                                    |                                     |                                       |                 |                        |                   |
| Fair value of Plan Assets at the beginning of the year  | 13,928,786                         | 3,407,239                           | 986,792                               | 50,552          | 1,106,147              | 19,479,516        |
| Actual Return on Plan Assets                            | 2,339,910                          | 674,626                             | 174,043                               | 4,655           | 133,656                | 3,326,889         |
| Contribution Received                                   | 1,214,127                          | 344,863                             | 122,165                               | -               | -                      | 1,681,156         |
| Benefits Paid   | (901,859)                          | (152,348)                           | (10,544)                              | (9,538)         | (81,704)               | (1,155,993)       |
| <b>Fair Value of Plan Assets at the end of the year</b> | <b>16,580,964</b>                  | <b>4,274,381</b>                    | <b>1,272,455</b>                      | <b>45,669</b>   | <b>1,158,099</b>       | <b>23,331,568</b> |
| <b>2008</b>   |                                    |                                     |                                       |                 |                        |                   |
| <b>Benefit Liability</b>                                |                                    |                                     |                                       |                 |                        |                   |
| Present Value of Benefit Obligation                     | 15,847,675                         | 3,643,074                           | 1,110,636                             | 43,194          | 866,162                | 21,510,741        |
| Fair Value of Plan Assets                               | (13,928,786)                       | (3,407,239)                         | (986,792)                             | (50,552)        | (1,106,147)            | (19,479,515)      |
| Unrecognised net Actuarial Gains/(Losses)               | (538,718)                          | (443,232)                           | (179,842)                             | 3,307           | 153,957                | (1,004,528)       |
| <b>Benefit Liability non-current</b>                    | <b>1,380,172</b>                   | <b>(207,397)</b>                    | <b>(55,999)</b>                       | <b>(4,051)</b>  | <b>(86,028)</b>        | <b>1,026,698</b>  |
| <b>Movement in the Benefit Liability</b>                |                                    |                                     |                                       |                 |                        |                   |
| At 1 January 2008                                       | 732,154                            | (247,154)                           | (78,927)                              | (7,925)         | (73,967)               | 324,182           |
| Benefit Expense   | 908,051                            | 39,757                              | 22,928                                | 3,874           | (12,061)               | 962,550           |
| Contribution Paid                                       | (260,034)                          | -                                   | -                                     | -               | -                      | (260,034)         |

| At 31 December 2008- Non-Current                        | 1,380,172         | (207,397)        | (55,999)       | (4,051)       | (86,028)         | 1,026,698         |
|---|-------------------|------------------|----------------|---------------|------------------|-------------------|
| <b>Benefit Expense</b>                                  |                   |                  |                |               |                  |                   |
| Interest Cost on Benefit Obligation                     | 1,121,626         | 238,553          | 69,038         | 2,660         | 61,191           | 1,493,067         |
| Expected Return on Plan Assets                          | (902,112)         | (224,217)        | (62,297)       | (3,421)       | (73,252)         | (1,265,299)       |
| Net Actuarial (Gain)/Loss recognized during the year    | 457,705           | 24,045           | 15,349         | -             | -                | 497,100           |
| Transitional Adjustment                                 | -                 | -                | -              | -             | -                | -                 |
| Net Current Service Cost                                | 230,832           | 1,376            | 838            | 4,635         | -                | 237,682           |
| Past Service Cost                                       | -                 | -                | -              | -             | -                | -                 |
| <b>Net Benefit Expense</b>                              | <b>908,051</b>    | <b>39,757</b>    | <b>22,928</b>  | <b>3,874</b>  | <b>(12,061)</b>  | <b>962,550</b>    |
| <b>Actual Return on Plan Assets</b>                     | <b>2,386,690</b>  | <b>536,912</b>   | <b>158,574</b> | <b>8,213</b>  | <b>185,968</b>   | <b>3,276,357</b>  |
| <b>Changes in Fair Value of Plan Assets</b>             |                   |                  |                |               |                  |                   |
| Fair Value of Plan Assets at the beginning of the year  | 12,028,159        | 2,989,565        | 830,632        | 45,608        | 976,689          | 16,870,653        |
| Actual Return on Plan Assets                            | 2,386,690         | 536,912          | 158,574        | 8,213         | 185,968          | 3,276,357         |
| Contribution Received                                   | 260,034           | 16,679           | 7,346          | -             | -                | 284,059           |
| Benefits Paid   | (746,097)         | (135,917)        | (9,759)        | (3,269)       | (56,511)         | (951,553)         |
| <b>Fair value of Plan Assets at the end of the year</b> | <b>13,928,786</b> | <b>3,407,239</b> | <b>986,792</b> | <b>50,552</b> | <b>1,106,147</b> | <b>19,479,515</b> |

The principal assumptions used in determining employee benefit obligations for all the plans are shown below:

|   | <u>2009</u> | <u>2008</u> |
|---|-------------|-------------|
| Discount Rate   | 10.00%      | 10.00%      |
| Expected Rate of Return on Assets                                       | 10.00%      | 7.50%       |
| Future Salary Increases   | 8.50%       | 8.50%       |
| Future Pension Increases  | 7.50%       | 6.50%       |
| Average Remaining years of Service – CBSL Pension W & OP Pension scheme | 2 years     | 2 years     |
| WR & OP Pension scheme  | 5 years     | 5 years     |
| Gratuity scheme   | 6 years     | 5 years     |
| CBSL Medical Benefit scheme   | 15 years    | 15 years    |
| Retirement Age  | 8 years     | 8 years     |
|   | 60 years    | 60 years    |

### 37. Financial Instruments

#### Fair Value of Financial Instruments

The fair value of financial instruments is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms-length transaction. When a financial instrument is traded in an organized and liquid market that is able to absorb a significant transaction without moving the price against the trader, quoted market values represent the fair value.

#### Financial Assets and Liabilities

All financial assets and liabilities are valued at either quoted market prices or prices derived from market yield curves, as described in the Bank's accounting policies, except as detailed below.

#### Repurchase and Reverse-Repurchase Agreements

The reported value of repurchase and reverse-repurchase

agreements is considered to approximate their fair value due to the short-term nature of the agreements. The carrying value of Sri Lanka Government Securities sold under agreements to repurchase as at 31 December 2009 was Rs. 6,000,000 (2008 – Rs. 13,743,000) and CBSL Securities was Rs.78, 022,645.

#### Currency in Circulation

The fair value of Currency in Circulation is considered to be its face value as reported in the Financial Statements.

#### Deposits

The carrying values of deposits are considered to approximate their fair value as they are payable on demand.

#### Assets Pledged

In order to facilitate the securities settlement process, AUD 39,000 & GBP 10,000 (carrying value AUD 36,953 & GBP 10,223) worth of securities (2008 – EUR 50,000 – carrying value 49,609) have been pledged by the Bank to the Euro Clear Bank and obtained a credit facility of USD 35,000 (2008 – USD 35,000). The pledged securities are held in a separate account at the Euro Clear.

### 38. Related Parties

#### 38.1 Transactions with State and State controlled entities

In the normal course of its operations, the Bank enters into transactions with related parties. Related parties include the Government of Sri Lanka (State: as the ultimate owner of the CBSL), various government departments, and state controlled entities. Particulars of transactions, and arrangements entered into by the Bank with the State and State controlled entities are as follows;

| Nature of transactions  | 2009<br>Rs '000 | 2008<br>Rs '000 |
|---|-----------------|-----------------|
| Investment portfolio of<br>Sri Lanka Government securities held by CBSL, as at 31 December (a)        | 43,450,557      | 159,771,674     |
| Outright sales of government securities<br>CBSL and Government  | 26,804,878      | 3,355,535       |
| Securities purchased / sold under agreement to repurchase/sales                                       | 1,751,900,559   | 135,561,027     |
| Cost of printing currency notes, for the period ended 31 December (d)                                 | 972,801         | 817,910         |
| Guarantees provided by CBSL, as at 31 December (Note 39)  | 1,148,253       | 898,129         |
| Funds collected in respect of Exchange Control Activities,<br>during the period ended 31 December (e) | 17,552          | 16,890          |
| Goods and Services and Taxes, during the year ended 31 December (f)                                   | 847,278         | 638,947         |
| Profit Advance to Government, during the<br>period ended 31 December (Note 23)                        | 20,000,000      | 8,000,000       |
| Advances to Government, as at 31 December (Note 7)  | 73,880,500      | 76,307,700      |
| Government Securities held for specific purposes  | 1,497,973       | 1,364,690       |
| Gross Foreign Exchange Transactions during the period (h)   |                 |                 |
| - Sales   | 94,689,937      | 173,314,334     |
| - Purchases   | 89,021,263      | 76,267,539      |
| - SWAP – USD LKR Sell- Buy  | 21,876,817      | -               |
| Refinances (j)  | 781,958         | 1,051,017       |

|  |   |
|--|---|
| <p>a) The Domestic Operations Department performs its direct functions of implementing the Bank's monetary policy mainly through open market operations as per the sections 90-92 of Monetary Law Act no 58 of 1949 as amended (MLA) and enforcing statutory reserve requirement as per the sections 93-98 of MLA and functions as the banker to both commercial banks where government has shareholdings and certain other financial institutions and governmental entities. The aggregate balances arising from this function as at 31 December 2009 are given in Note 17 and 18. Interest earned on the investment portfolio is given in Note 24.</p> <p>b) Empowered by the sections 28-33 of the MLA the Bank Supervision Department of CBSL carries out the regulatory and supervisory functions of the banks licensed by the Monetary Board of Central Bank. During the reporting period, 2 licensed commercial banks and 13 licensed specialized banks, which had been funded by the government or has a significant influence, came under the supervision of the department.</p> <p>The Department of Supervision of Non-Bank Financial Institutions of CBSL carries out its regulatory and supervisory functions in respect of Non-Bank Financial Institutions. Accordingly, related entities of State controlled or funded banks are under the supervision of the Dept. of Non-bank Financial Institutions.</p> <p>c) As per the Section 113 of MLA, the Monetary Board and the CBSL are vested with the function of public debt management. Accordingly, as the agent of the Government, the Public Debt Department (PDD) issues securities to the domestic market to meet the budgetary requirements of the Government and services both foreign and domestic debt. The PDD deals with public</p> | <p>debt management and debt market development. It manages the Government debt to ensure that financing needs of the government and its payment obligations are met.</p> <p>d) The Bank has the sole right and authority to issue currency in Sri Lanka as per section 49 of the MLA. Accordingly, the Currency Department of CBSL functions as the sole issuing authority of the legal tender in Sri Lanka. Printing of the currency notes is carried out by De La Rue Lanka Currency and Security Print (Pvt) Ltd., of which the Government owns 40% shareholding.</p> <p>e) The management and regulation of receipts and payments of foreign exchange into and out of the country is the key function of the Exchange Control Department. In carrying out such functions, the penalties imposed are collected on behalf of Ministry of Finance to be credited to the Consolidated Fund of the Government.</p> <p>f) In carrying out the normal operations, the Bank enters into transactions to obtain various goods and services with government entities or entities in which government has significant influence or control.</p> <p>g) The Bank commonly acts as trustees and in other fiduciary capacities that result in the holding or placing of assets and liabilities on behalf of government, trusts, retirement benefit plans and other institutions, as explained in Note 40.</p> <p>h) International Operations Department of the Bank monitors the developments in the domestic foreign exchange market and overnight net foreign exchange open positions of commercial banks. In monitoring the domestic foreign exchange market developments, the Bank is on both sides of the market to moderate the excessive volatility</p> |
|--|---|

in the exchange rate of Sri Lanka Rupee. The amounts of purchases and sales of foreign exchange represent results of such monitoring activities.

- (i) The Bank has also had custodial arrangements with one state-controlled bank, for which no charges were levied.
- (j) The Bank provides refinance loans for which credit guarantees are provided as described in note 39.2 of which CBSL funded projects amounted to Rs. 781,958 (2008 - Rs. 1,051,017) and Government funded projects amounted to Rs.2, 970,035 (2008 - Rs. 5,748,653).

### 38.2 Transactions with Other Entities in which the Bank has Significant Investments

During the year the Bank received an amount of Rs. 25,163 (2008 – 9,048) as dividend income from investments it has in Associates given in Note 9.

### 38.3 Transactions with Key Managerial Personnel

Key Managerial Personnel of the Bank are the members of the Monetary Board that includes Governor, (MLA restricts such members' positions as director, officer, employee or shareholder of any banking institution.), Deputy Governors, Assistant Governors and Director Management Audit. Particulars of transactions with Key Managerial Personnel are as follows:

#### Compensation to the Members of Monetary Board:

|                              | 2009<br>Rs '000 | 2008<br>Rs '000 |
|------------------------------|-----------------|-----------------|
| Short Term Employee Benefits | 57,641          | 47,136          |

In addition to above compensation the Bank also provides non-cash benefits to Key Management Personnel in terms of employment contracts with them.

### 38.4 Other Transactions with Key Managerial Personnel

|                                   | 2009<br>Rs '000 | 2008<br>Rs '000 |
|-----------------------------------|-----------------|-----------------|
| Loans to Key Management Personnel | 13,536          | 4,426           |

All the loans are adequately secured carry interest rates ranging from 2 per cent – 19 per cent depending on the loan category and are repayable monthly.

### 38.5 Transactions with Post Employment Benefit Plans

|                                | 2009<br>Rs '000 | 2008<br>Rs '000 |
|--------------------------------|-----------------|-----------------|
| Contributions paid and payable | 20,605          | 16,440          |

The Bank contributed various amounts to Pension and Other Post Retirement Plans as disclosed in Note 36 and Rs. 113,065 (2008 – Rs.190, 927) to Employees Provident Fund (EPF). There was no necessity to make an interest subsidy payment to the EPF in 2009 as the fund recorded a surplus

return (Interest subsidy 2008-Rs 468,165). In the normal course of business the Bank provides banking and financial services to its post employment plans. Amounts of balances with such plans are given in Note 19.

## 39. Contingent Liabilities and Capital Commitment

### 39.1 Financial Guarantee Contracts

The Bank acting as the agent of the government or its agencies and institutions, provides guarantees to various parties on the strength of counter guarantees issued to CBSL by the General Treasury. There were no such outstanding guarantees as at 31 December 2009.

### 39.2 Credit Guarantees

The Regional Development Department (RDD) of the Bank performs the functions of providing refinance out of loan proceeds from external lines of credit to participating credit institutions for financing small and medium enterprises; issuing credit guarantees on loans to such enterprises; collecting guarantee premia; administering credit guarantee funds and undertaking post credit inspection and follow up action to ensure proper utilization of loan funds with a view to preventing defaults. During the year RDD continued to provide refinance facilities under which the Bank provided guarantees against losses arising to a participating credit institution, which grants credit under this arrangement. This is not a guarantee on default by recipient of loans but against loss, which means that participating credit institutions should submit claims only in respect of amounts in loss after having pursued recovery action. The amount of contingent liabilities arising out of these arrangements is given below.

Local Commercial Banks – in respect of credit guarantees;

| Guarantee                      | Outstanding Guarantee Amount |                  |
|--------------------------------|------------------------------|------------------|
|                                | 2009<br>Rs. '000             | 2008<br>Rs. '000 |
| <b>Related Parties</b>         |                              | 898,129          |
| CBSL Funded Projects           | 213,659                      |                  |
| GOSL Funded Projects           | 934,594                      |                  |
| <b>Others</b>                  |                              | 1,841,706        |
| CBSL Funded Projects           | 1,387,591                    |                  |
| GOSL Funded Projects           | 326,457                      |                  |
| <b>Total Credit Guarantees</b> | <u>2,862,301</u>             | <u>2,739,835</u> |

How ever the total credit guarantee liability is covered by the funds in the Credit Guarantee Fund maintained by the RDD.

### 39.3 Guarantee under Deposit Insurance

Bank administers the Deposit Insurance Scheme which is a voluntary deposit insurance scheme opened to banking institutions licensed by the CBSL and cooperative societies registered under the Cooperative Societies Law No. 5 of 1972, which carry on banking business. As at 31st December the Bank has guaranteed deposits of one entity amounting to Rs. 887,857 (2008 – Rs. 880,352), which continued to pay premia to qualify for this scheme.



### 39.4 Fiduciary Activities

The Bank carries out fiduciary activities under the provisions of Monetary Law Act. Acting in such capacity results in holding or placing of funds on behalf of various parties. However, the Bank does not expect any liability to arise on account of such activities.

### 39.5 Legal Claims

The Bank is a defendant in 88 cases where legal action has been instituted by stakeholders of entities involved, claiming Rs. 44,021 with legal interest. The cases are being contested by the Bank and no provision has been made in the financial statements. Further, there were a number of legal proceedings outstanding against the Bank as at 31 December 2009. No provision has been made, as the Bank is of the opinion that it is unlikely that any significant loss will arise.

### 39.6 Commitments

- a) As at 31 December 2009 the Bank has capital commitments of Rs. 51,230 (2008 – Rs. 41,296), in respect of the acquisition of Property, Plant and Equipment.
- b) As at 31 December 2009 the Bank has entered into Forward Contracts amounting to USD 245,000 & JPY 500.
- c) As at 31 December Bank has a commitment of Rs.1, 310,525 being the cost of Treasury bills purchased (face value Rs.1, 410,000) and Rs. 8, 560 as With Holding Tax arising on the interest on such bills.

### 39.7 Contingent Liability against Sovereign Residencies

As per the lease agreement entered between the Monetary Board of the Central Bank of Sri Lanka (CBSL) and S.W.R.D.Bandaranayake National Memorial Foundation to operate Sovereign Residencies, the subsequent investments made by the lessee to the premises should be agreed by both parties and be recorded. In the event the agreement is terminated the CBSL, as the lessor would have to pay an agreed percentage of the value of the investment based on the year of operation. At the end of the year 2009 the contingent liability of the CBSL as the lessor is estimated at Rs. 26, 319 (2008 – Nil) being the 60% of the investment value considered at the end of first year of operation.

### 40. Trust and Custodial Activities

The Bank commonly act as trustees and in other fiduciary capacities that result in the holding or placing of assets and liabilities on behalf of government, trusts, retirement benefit plans and other institutions. The significant trust activities performed by the Bank are as follows:

- a) The Bank handles disbursements and repayments of various foreign loans and, grants under foreign funded development projects and credit schemes on behalf of

the Government of Sri Lanka (GOSL). It also collects counter party funds under various foreign loans and grants on behalf of GOSL and invests such funds in treasury bills on requests made by donor agencies.

- b) The Bank is the custodian of the Employees Provident Fund (EPF). In terms of the statute, the functions of the Monetary Board consist of receiving contributions, surcharges, income from investments, maintaining proper accounts of registered members of EPF, investing surplus funds and payment of benefits to the members.
- c) The Bank administers the Deposit Insurance Scheme, which is a voluntary deposit insurance scheme open to banking institutions licensed by the CBSL and cooperative societies registered under the Cooperative Societies Law No 5 of 1972, which carry on banking business.
- d) The Bank carries out regulatory and supervisory functions in respect of registered finance companies (FCs) and attends to related matters under the authority delegated to it by the Monetary Board. While carrying out such functions, with respect to failed FCs, various actions are taken, including the vesting of assets of persons responsible for the unviable and insolvent condition of such companies, with the Monetary Board as a form of security.
- e) Transactions with entities where action is taken under Section 30(1) of the MLA.

#### Temporary Liquidity Facility

Maintenance of financial stability is one of the core objectives of the CBSL. Hence, in December 2008, under provisions of section 30 (1) of the MLA, the CBSL took action with respect to one LCB, which was encountering liquidity problems, in view of its systematic importance. The CBSL has provided a liquidity facility to this LCB in the form of SWAPs amounting to a total of USD 18 million in December 2008 for a period of 3 months and a loan of Rs. 2,200,000 in January 2009 for a period of 14 days.

- f) Bank is temporarily in custody of Rs. 371,222 collected from licensed commercial banks under the Banking Act Direction No. 5 of 2009 – Identifying, reporting, terminating and maintaining abandoned property of licensed commercial banks (LCBs). These funds are to be transferred to the Consolidated fund of the Government Treasury for contribution as initial capital for the establishment of a mandatory Deposit Insurance scheme.

### 41. Events Occurring Subsequent to Statement of Financial Position date

There were no material events occurring subsequent to the Statement of Financial Position date that require adjustment or disclosure in the financial statements.

## 2. BANK SUPERVISION

The Bank Supervision Department (BSD) was established under Section 28(1) of the Monetary Law Act to carry out the continuous supervision and periodic examination of all banks licensed by the Monetary Board. The functions of BSD are mainly focused on ensuring the safety and soundness of the banking system and safeguarding the interests of depositors and other creditors of banks. As at end of 2009, 36 licensed banks comprising 22 Licensed Commercial Banks (LCBs) and 14 Licensed Specialised Banks (LSBs) were in operation. The names of these banks are given in alphabetical order in Annex - I. Major activities of BSD are formulation and implementation of prudential regulations, conduct of continuous supervision and periodic examination of banks to ascertain their true positions, processing of requests for regulatory approvals and administering the voluntary deposit insurance scheme. The main activities carried out by BSD in 2009 are summarised below.

### 2.1 Prudential Regulations to Strengthen Risk Management

During 2009, BSD introduced new prudential regulations and several amendments to existing regulations to licensed banks. While details of these prudential regulations are contained in Part III of this Report, a summary of the major changes is given below.

- (a) Maximum time to reduce ownership in excess of 15 per cent in banks: The Directions issued in 2007 were amended to enable the Monetary Board to determine the maximum time period to reduce any shareholding acquired in excess of 15 per cent, on a case-by-case basis, under certain exceptional circumstances.
- (b) Withdrawal of margin requirements on imports: Margin requirements imposed jointly by the Director of Bank Supervision and the Controller of Exchange on imports of selected commodities, selected categories of motor vehicles and forward contracts for sale of foreign exchange were withdrawn.
- (c) Foreign Exchange Risk Management in LCBs: Directions on risk management relating to foreign exchange business of LCBs were issued with a view to mandating Board level involvement in formulation of policies, procedures and robust internal control mechanisms to govern foreign exchange activities of LCBs and to ensure the fitness and propriety of personnel engaged in foreign exchange business in banks.
- (d) Approved securities for granting accommodation to directors and their related parties/concerns: The banks were permitted to consider leased-backed trust certificates/lease receivables as approved securities for granting such accommodation.

- (e) Abandoned property in LCBs: To further strengthen the regulations issued, new Directions were issued to provide the procedure for classification and transfer of abandoned property, i.e., money and articles held in banks without any transaction for a long period, and meeting subsequent claims of customers of banks.
- (f) Minimum capital requirement: The banks that were not able to comply with the minimum capital requirement (Rs. 2.5 bn for LCBs and Rs. 1.5 bn for LSBs) were granted a final extension until June 2010 to comply with the requirement.

### 2.2 Approvals for Banks, Branches and other Banking Outlets (Figures given are provisional)

- (a) During the year, approvals were granted for the opening of 103 new branches, 406 other banking outlets such as Extension Offices (EOs) and Student Savings Units (SSU), relocation of 41 branches and 19 EOs and upgrading of 7 EOs to fully fledged branches, installation of 45 off-site Automated Teller Machines (ATMs) and closing of one ATM. These include approvals for the opening of 75 new branches and 72 EOs in the Northern and Eastern provinces under the "Flourishing North" and "Re-awakening East" programmes with a view to assisting rehabilitation work and improving access to finance. Accordingly, at the end of 2009, there were 1,838 branches, 3,844 other banking outlets and 1,856 ATMs in operation.
- (b) The validity period of the letter of provisional approval issued to Amana Investments Ltd. to commence operations of the first commercial bank providing solely Islamic banking services was extended until 31.12.2010. Another letter of provisional approval was issued to Axis Bank Limited in Mumbai, India, for the setting up of a branch in Sri Lanka.

### 2.3 Continuous Supervision of Banks

This entails an ongoing monitoring process to identify critical and significant changes in the financial condition of banks on the basis of periodical information submitted by banks through the on-line web based reporting system. The BSD uses this process as an early warning system to identify concerns on risk profiles of banks that need further investigation, examination and corrective actions. In addition, reports were compiled on specific issues while follow-up on the progress reported by banks on the corrective actions on key supervisory concerns raised during examinations was also carried out.

Several meetings with Boards of Directors, senior management and external auditors of banks were held in 2009 with a view to facilitating and ensuring that the banking system is well geared to face new challenges in rapidly growing banking operations.

## 2.4 Examination of Banks

The Monetary Law Act and the Banking Act require BSD to conduct periodic examinations of banks. The BSD continued to adopt a risk based approach that focuses on identification of risks, management of risks and assessment of resources to mitigate risks. BSD conducted examinations of 17 banks that continued from 2008 and examinations of 14 banks that commenced in 2009. Accordingly, the examinations of 13 banks were completed in 2009 through formal discussions with the management of the respective banks and submission of reports to the Monetary Board while 18 examinations were in the process of completion. In addition, several examinations of limited scope were also carried out by BSD on several timely issues.

## 2.5 Resolution Actions

- (a) Further to timely actions taken by the Monetary Board in December 2008 to restore the depositors' and creditors' confidence on the Seylan Bank (SBL) PLC, in 2009, SBL was recapitalized (approximately Rs. 3 bn) and the liquidity constraints were resolved through continued resolution action. The bank is currently carrying on its normal operations independently by its board of directors appointed by shareholders, inclusive of directors representing the new shareholders.
- (b) Further, the Monetary Board also appointed a managing agent, Merchant Bank of Sri Lanka PLC, to the Ceylinco Savings Bank Ltd., a licensed specialised bank, to resolve its weak financial position and restore normal operations. Subsequently, a capital infusion (Rs. 100 million) was made by the managing agent and the bank was re-named as MBSL Savings Bank Limited. The bank is currently carrying on its operations under the new board of directors and its financial condition has improved to a healthy level.

## 2.6 Bank Chief Executive Officers' Meetings

The monthly meetings of Chief Executive Officers (CEOs) of licensed banks, which serve as a forum for exchanging views on prudential regulations, policies and other issues pertaining to the banking industry, continued in 2009 as well. CEOs were apprised of economic and monetary developments and the banking sector performances to facilitate their decision making. Some of the matters discussed were adoption of Sri Lanka Accounting Standards 44 and 45, proposed amendments to the Banking Act, measures to address the rising trend in non-performing advances, reduction in lending rates, expansion of private sector lending and disclosures on internal controls.

## 2.7 Other Activities

### (a) Identification of Assets and Preparation of Depositors' list of failed Golden Key Credit Card Company Limited (GKCL)

Consequent to a number of Fundamental Rights Applications filed before the Supreme Court to obtain relief upon the failure of GKCL to repay its investors, the Supreme Court directed the Monetary Board to compile a list of assets. Accordingly, a 'Special Task Force' was established within BSD to identify assets and liabilities of GKCL. In this regard, BSD conducted several investigations into books and records of GKCL and its related companies and prepared a list of assets of failed GKCL, its directors, senior staff and other related and relevant parties and submitted the same to the Supreme Court. The details of liabilities of GKCL were submitted to the Committee of Chartered Accountants appointed by the Supreme Court for necessary action.

### (b) Adoption of Sri Lanka Accounting Standards (SLAS) 44 and 45

In 2009, the CBSL continued to facilitate the adoption of SLAS 44 and 45 corresponding to International Accounting Standards (IAS) 32 and 39 by banks. Accordingly, five workshops for bank officials were held by BSD. Further, a committee comprising representatives from Sri Lanka Banks' Association (SLBA), Institute of Chartered Accountants of Sri Lanka (ICASL) and bank auditors was constituted to facilitate the transition to the new accounting standards. The progress on the preparedness of banks for implementation of the two SLASs was reviewed by examining the parallel data reported by banks. In addition, banks were requested to carry out detailed gap analysis and formulate time bound action plans to address material gaps in areas of policies, procedures, staff competencies and IT system, on a priority basis to adopt the Standards.

### (c) Monitoring of Mandatory Lending to Agriculture Sector

BSD continued to monitor the progress made by licensed banks in achieving the 10 per cent mandatory lending requirement to the agriculture sector. More than 70 per cent of banks have achieved the 10 per cent mandatory target by 31.12.2009. The Monetary Board required the banks that were unable to meet the stipulated target to provide funds to banks of their choice to re-lend such funds to the agricultural sector. The banks that were unable to meet the targets in such manner were subsequently required to transfer the shortfall to a fund established in the CBSL.

**(d) Monitoring on Lending**

Following the reduction in the money market rates consequent to the monetary policy stance by the Central Bank, banks were requested to reduce their lending rates to facilitate lending activities and repayment of loans. Further, banks were requested to pay greater attention on improving access to credit in the Northern and Eastern provinces and enhancing lending to the small and medium industry sector.

**(e) Proposed Amendments to the Banking Act**

With a view to further strengthening the supervisory and regulatory framework in line with best practices and standards, BSD completed and proposed several amendments to the Banking Act. These amendments are aimed at facilitating consolidated supervision, strengthening the supervisory framework, including bank resolution framework and aligning provisions in the Banking Act with the requirements of the new Companies Act. While banks were given an opportunity to respond to the proposed amendments, a committee comprising bank representatives and officers of BSD is in the process of finalising the amendments.

**(f) Inter Regulatory Institutions Council**

The Director of BSD continued to be a member of Inter Regulatory Institutions Council (IRIC) and attended the meetings held in 2009. IRIC is responsible to ensure that appropriate policy direction is set out for orderly development of financial markets and ensure all regulatory agencies coordinate and exchange information in the interest of the wider financial system stability. Some matters discussed were introduction of a new law to overcome restrictions in sharing of information, measures to maintain public confidence in the domestic financial system and restrain operations of unauthorised deposit taking activities, formulation of a regulatory framework for micro-finance institutions, strengthening the effectiveness of internal audit function in regulated companies and development of capital market activities.

**(g) Actions on Prohibited Schemes**

BSD continued to conduct investigations into the prohibited schemes stipulated in Section 83C of the Banking Act. In this regard, BSD attended to court proceedings and facilitated law enforcement authorities relating to 8 cases heard in the Magistrate's Courts of Anuradapura, Balapitiya, Maho, Kurunegala, Panwila, Teldeniya, Attanagalla and Minuwangoda.

**(h) Litigation**

BSD continued its work relating to litigation on several matters in the District Court, High Court, Court of Appeal, Supreme Court and Labour Tribunal. BSD handled 24 court cases in 2009. The year end position of the cases was that 13 of such cases were pending, 3 cases were dismissed, 3 cases were withdrawn by the Petitioners, 2 cases were laid by, the CBSL discontinued as a party in 2 cases and one case was settled.

**(i) Annual Licence Fee**

The Monetary Board with a view to partially recovering the cost of bank supervision had decided to increase the annual licence fee on a staggered basis. Accordingly, the licence fee for 2010 would be Rs. 1,000,000 for LCBs conducting both domestic banking business and off-shore banking business, Rs. 600,000 for LCBs conducting only off-shore banking business and Rs. 300,000 for LSBs.

**(j) Awareness Programmes**

The BSD conducted the second Bank Directors' Symposium on "Meeting the Challenges in the New Era" with a view to improving awareness among bank directors of their responsibilities and updating them on new developments and opportunities. Dissemination of information to the public was continued by BSD in 2009 to educate the public on their transactions with financial institutions. Accordingly, newspaper advertisements in Sinhala, Tamil and English were published regularly informing the public of the lists of banks authorized to accept public deposits, fraudulent methods of prohibited schemes of pyramid nature and risks involved in participation in such prohibited schemes.

**(k) Administration of the Voluntary Deposit Insurance Scheme**

The BSD continued to administer the voluntary Deposit Insurance Scheme, which commenced operations in 1987. This scheme is open to banking institutions licensed by the CBSL and co-operative societies registered under the Co-operative Societies Law No.5 of 1972, which accept deposits. Currently, only one Multi-Purpose Co-operative Society has insured itself under the scheme in respect of deposit liabilities of its rural banks. The deposit insurance fund, consisting of the premium collected and Rs. 50 million allocated by the CBSL in 1997, stood at Rs. 291.6 million as at 31 December 2009. These funds have been invested in government securities.

**Annex -I**  
**Licensed Commercial Banks**

- Bank of Ceylon
- Citibank N.A.
- Commercial Bank of Ceylon PLC
- Deutsche Bank AG
- DFCC Vardhana Bank Ltd.
- Habib Bank Ltd.
- Hatton National Bank PLC
- ICICI Bank Ltd.
- Indian Bank
- Indian Overseas Bank
- MCB Bank Ltd.
- National Development Bank PLC
- Nations Trust Bank PLC
- Pan Asia Banking Corporation PLC
- People's Bank
- Public Bank Berhard
- Sampath Bank PLC
- Seylan Bank PLC
- Standard Chartered Bank
- State Bank of India
- The Hongkong & Shanghai Banking Corporation Ltd.
- Union Bank of Colombo Ltd.

**Licensed Specialised Banks**

- DFCC Bank
- Housing Development Finance Corporation  
Bank of Sri Lanka
- Kandurata Development Bank
- Lankaputhra Development Bank Ltd.
- MBSL Savings Bank Ltd.
- National Savings Bank
- Rajarata Development Bank
- Ruhuna Development Bank
- Sabaragamuwa Development Bank
- Sanasa Development Bank Ltd.
- Sri Lanka Savings Bank Ltd.
- State Mortgage and Investment Bank
- Uva Development Bank
- Wayamba Development Bank

### 3. CENTRE FOR BANKING STUDIES

The Centre for Banking Studies (CBS) conducted high level local and international training workshops, seminars, conferences, and public awareness programmes for practitioners in the banking and financial sector institutions, students and the general public during the year 2009.

CBS conducted 88 training programmes, out of which 56 were scheduled local programmes while 27 were special programmes conducted on demand. CBS was able to conduct 5 international programmes by attracting international participants in the region. More than 2,500 participants attended these scheduled programmes. With a view to creating a multi-skilled workforce in the financial sector, CBS has taken steps to broaden its coverage of programmes beyond its core areas of training in the recent years. Accordingly, such programmes covered the areas of banking and finance, accounting and financial management, laws/regulations relating to financial institutions, information technology, languages and communication skills, micro finance and human resources, marketing, and general management. In addition, special programmes on important policy issues and financial sector developments too were conducted during the year. According to the evaluations by participants, the programmes conducted by CBS during the year were ranked as of high quality.

CBS continued its attempt to share knowledge with the general public by conducting a series of public seminars, evening presentations and special educational programmes for school children and teachers. The main objective of these programmes was to disseminate knowledge among participants and to provide a forum for the general public to express and share their views. In 2009, 10 public seminars, 03 evening presentations and 27 school programmes were conducted with the participation of approximately 6,000 people.

Furthermore, CBS took initiatives to create new links with universities, international training and development institutions with the intention of sharing knowledge and skills.

In order to provide a better learning environment, CBS has taken steps to upgrade its facilities to suit international standards and to serve its stakeholders better in its journey towards becoming an international centre of excellence.

### 4. COMMUNICATIONS

The year 2009 was a challenging year for most of the central banks around the globe. Situation in Sri Lanka was not an exception. The communication activities of Central Bank of Sri Lanka (CBSL) played a pivotal role in managing expectations and speculations of different stakeholders. Communication activities were intensified to arrest the possible crisis situation while maintaining high standards and accuracy.

The website of the CBSL maintained by the Communication Department (CMD) played an important role as the main communication gateway linking the worldwide audience to the CBSL. It attracted a record number of visitors during the year in reference, totalling 53.7 million. The average number of visitors per day increased noticeably by 42% to 146,398 in 2009, when compared to that of 103,012 in 2008. Visitors were provided with an opportunity to purchase commemorative coins and publications through the online sales facility. During the reference period, online sales recorded sales of 223 commemorative coins and notes, 35 coin packs and 5 publications. The website has been regularly updated adding more features to it. Arrangements have been made to introduce Real Simple Syndication (RSS) facility and video clips to the site in year 2010. The site is maintained in English, Sinhala and Tamil.

As in previous years, CMD continued to release information on daily exchange rates, weekly and monthly economic indicators, Sri Lanka Inter Bank Offered Rates, oil prices, consumer price indices and information on government securities, such as Treasury bills and Treasury bonds auctions. During the year, CMD released 1,854 press releases, published 147 newspaper advertisements and 6 Gazette notifications. In addition to regular press releases and notices, CMD organized 37 media conferences and arranged a number of one-on-one media interviews with the senior officials of the CBSL to create constant public awareness on various economic and financial issues.

A 'Help Desk' was established with the objective of responding to frequent inquiries made by the public, especially on vulnerable financial institutions. On an average, the help desk has responded to 50 -55 inquiries per day and around 200 phone calls on peak days.

In order to cater to internal communication needs of the staff, the CMD continuously updated the CBSL daily web-portal which provides the staff with information ranging from weather report to local and foreign news relating to banking and finance, important economic indicators, presentations, announcements and notices to employees, and links to other departmental websites. The CMD continued to publish 'Kauluwa', the internal news and features magazine, with added features and provided opportunities to employees and associations operating in the CBSL to express their views and ideas on various related issues.

As in previous years, the corporate management was provided daily with a collection of news, articles and public opinions on country's economy and on CBSL published in the national newspapers. A total of 1,359 such news items on various economic, financial and social issues were submitted to the management. Newspaper reports were summarized to analyse how the CBSL is portrayed

in the media and a half yearly report was submitted to the management on the findings. Erroneous reports published in the media were well addressed and corrected with the assistance of relevant departments.

As a means of increasing public awareness on central banking related issues, 30 public awareness programs and school seminars on economics, banking and finance were conducted during the year. As per the request of the Regional Development Department of the CBSL, two documentary video films promoting vanilla and goat farming as a profitable household economic activity were produced. These programmes were telecast over national television channels for the benefit of the general public and DVD copies were made available for free distribution among the potential farmers. The CMD participated in various exhibitions and other public events to enhance the public awareness on economics and finance and on policies and responsibilities of the CBSL. The stall of the CBSL at the Colombo International Book Fair and Deyata Kirula exhibitions recorded a significant public participation. Mahapola and the Forum for Sri Lankan Expatriates were among other notable exhibitions for which the CBSL's participation of the CBSL was coordinated and arranged by CMD. The CMD, through the participation at these exhibitions, managed to increase public awareness on policy changes and current issues and also to sell a large number of its publications.

The Tamil Translation Unit set up at the CMD fulfilled all the Tamil translation requirements of the CBSL during the year. In addition to maintaining the Tamil version of the website, the unit completed 223 Tamil translation assignments during the year. The Unit was able to publish most of the Press releases, advertisements, gazette notices and other publications in the Tamil language.

As in previous years, CMD continued to publish its own publications such as Satahana and News Survey in addition to serving as the publishing arm for other publications published by the CBSL. The CBSL Printing Press continued to serve for almost all the printing needs of the CBSL. The Sri Lanka Socio Economic Data, Economic and Social Statistics of Sri Lanka, News Survey, Satahana, Kauluwa, Staff Studies, Financial System Stability Review, Road Map, Strategic Plan, Public Debt Bulletin and other printing requirements such as visiting cards, greetings cards, notepads, file covers, CBSL diary and departmental research publications were some of the printing work undertaken by the press.

Photographic Unit of the CMD provided coverage for all the major events conducted by the CBSL. 130 such events within and outside the CBSL premises were covered during the reference year.

## Library and Information Centre (LIC)

The Library and Information Centre (LIC) continued to provide library services for the CBSL staff and others on request. It increased its collection of books from 21,907 to 23,476, reports from 14,663 to 15,229, CDs from 1,143 to 1,430 and added 500 bound volumes to the collection during the year. The Library at the Centre for Banking Studies too increased its collection of books from 5,517 to 5,683.

The usage of the 'Science Direct' database, which gives on-line access to over 100 journals on economics, econometrics and finance was increased in 2009. The total number of foreign and local journals subscribed by LIC are 115 and 52, respectively. LIC continued to compile electronic publications such as Recent Additions (i.e. new books), List of Selected Articles, News on Central Banking, News Alert and disseminated them via intranet. A Selective Dissemination of Information (SDI) service was also maintained.

In order to encourage the CBSL staff to use on-line library facilities, 6 user education programmes covering 6 departments were conducted. For the benefit of the employees, 7 documentary films, produced on various important topics and subjects, were shown during the lunch interval at the Lobby of the LIC. Economics and Banking Library Network of Sri Lanka (EbanklibnetSL) was maintained and its 23 member libraries were benefited immensely by sharing information via e-mail. LIC organized a book exhibition during the National Reading Month in October, exhibiting 450 new titles purchased. A good response was shown by the staff for this exhibition. The Book Review Competition, Selection of the Best Reader and Quiz Programme by e-mail were other popular items organized to mark the National Reading Month Programme.

Self Access Language Laboratory, housed in the Reference Section of the LIC was made available to CBSL staff. Library services were maintained in compliance with ISO 9001 : 2000 standard awarded to the LIC in 2008.

## 5. CURRENCY

### 5.1 Currency Issue and Management

The CBSL, as the sole currency issuing authority in Sri Lanka, continued to perform the function of issuing legal tender during the year 2009. The value of currency notes and coins in circulation by the end of 2009 stood at around Rs. 217 billion. Notes in circulation comprised 98 per cent of the total value of currency in circulation. The values of new and serviceable currency notes issued to commercial banks by the Currency Department (CRD) during the year 2009 were around Rs. 49 billion and Rs. 169 billion, respectively. The value of the deposits of currency notes from commercial banks with the CBSL was around Rs. 187

billion. Accordingly, the net issue of currency notes and coins into circulation by the end of 2009 stood at Rs. 31 billion and Rs. 207 million, respectively.

### 5.2 Cost-effective Measures for Issuing and Managing Currency

The island-wide Coin Collection Programme conducted aiming to collect idle coins accumulated in the household sector was completed in 2009 by conducting this programme in the Colombo and Gampaha districts, which were the last two districts to be covered under this programme. The total face value of coins collected under the entire programme was around Rs. 56.4 million. The total net benefits in terms of savings were around Rs. 87.2 million, considering the cost of minting the stock of coins collected as against the cost incurred by the CRD on the Coin Collection Programme.

The main functions of the CBSL with respect to currency issue and management is to issue new currency notes and coins to circulation and to withdraw unserviceable currency notes and coins from circulation. However, in addition to the above two main functions, the CBSL also accepts serviceable notes as deposits, processes them and re-issues them to facilitate transactions. Until 2009, all currency services CBSL provided to commercial banks were free of charge. However, with increasing cost of providing such services, the Monetary Board took a decision to collect a service charge from commercial banks in order to reduce the cost of such services provided by the CBSL. Accordingly, the CBSL started to collect a service charge on serviceable currency deposits by banks. Accordingly, a charge of Rs. 200 on each bundle of the denomination Rs. 500 and above, and a charge of Rs. 100 on each bundle of the denomination of Rs. 100 and below were collected since 2nd March 2009.

### 5.3 Preserving Public Confidence in Currency

To maintain public confidence in currency, which is one of the responsibilities of the CBSL, the CRD continued to work in close cooperation with the Counterfeit Currency Bureau of the Criminal Investigation Department (CID). Similarly, the CRD attended 48 court cases on counterfeiting during the year. The volume of counterfeit notes detected and referred to the CBSL for certification in 2009, was around three notes per million notes in circulation. There is a slight increase in counterfeit notes in 2009 when compared to the level in 2008. This increase was due mainly to the increase in the number of counterfeit notes found in each identified incidence. The CRD also conducted public awareness programmes on security features of genuine currency notes to enhance knowledge of law enforcement officers, cash handlers and the general public to enable them to distinguish between genuine currency notes and counterfeits. Meanwhile, measures were taken to introduce advanced security features in the new series of currency notes scheduled to be issued in 2010.

### 5.4 Promoting Clean Note Policy

Maintaining clean notes in circulation has multidimensional benefits to currency issue and management. Clean notes help distinguish between genuine currency notes and counterfeits. They also boost the image of the nation among foreigners. Good habits of handling notes extend the life span of notes and helps to reduce the cost of printing new notes. The CRD continued with issuing new notes into circulation, while removing unserviceable currency notes as part of promoting the Clean Note Policy. Further, topics on good habits of handling currency notes and coins were discussed in the awareness programmes conducted by the CRD during the year. In order to ensure that the guidelines issued to commercial banks on sorting standards for currency notes are adhered to, random checks of note bundles deposited by commercial banks were carried out on a daily basis.

### 5.5 New Projects Implemented

The initial designing process of the new currency note series under the theme of “Development, Prosperity and Sri Lankan Dancers” was completed. The new series is scheduled to be issued to coincide with the 60th Anniversary of the CBSL.

The first money museum of the Central Bank which was established in 1982 and presently located at the premises of the Centre for Banking Studies at No. 58, Sri Jayawardenapura Mawatha, Rajagiriya, was renovated and modernized to a state of the art museum. It was re-opened for the public on 28 August 2009, coinciding with the 59th Anniversary of the CBSL.

### 5.6 Promoting Awareness on Currency

The CRD conducted awareness programmes on the identification of counterfeit notes, clean note policy and re-circulation of coins for bank officers, police officers, school children, government employees and the general public through public lectures, seminars and electronic and print media. The number of such programmes conducted during 2009 was 30. Furthermore, the CRD executed an advertising campaign through the national newspapers, to educate the public on consequences of mutilation and counterfeiting of currency notes. The CRD also participated in 6 exhibitions with a view to enhance public awareness on currency notes and coins and its historical developments in Sri Lanka. All these exhibitions were well patronised by school children and members of the public.

### 5.7 Commemorative Coins and Notes

The CBSL issued two new commemorative coins in 2009. The first was a silver coin issued to mark the 200<sup>th</sup> Anniversary of the Sri Lanka Customs in the denomination of Rs. 200. The second set of coins, a silver coin and a

copper/nickel coin, both in the denomination of Rs. 1000, were issued to commemorate the 60<sup>th</sup> Anniversary of the Sri Lanka Army. A commemorative note in the denomination of Rs.1,000 to mark the Ushering of Peace and Prosperity to Sri Lanka was also issued in November, 2009. It was the second commemorative note issued by the CBSL.

The CRD continued to sell commemorative coins, coin packs and commemorative notes to numismatists and collectors by implementing effective sales promotion strategies.

### 5.8 Human Resource Development

Language and presentation skills development programmes for the newly recruited employees of the CRD were conducted as in-house programmes. Forty-six officers of the CRD participated in local training programmes offered by the Centre for Banking Studies and six officers had the opportunity of participating in 05 international seminars/conferences in 2009.

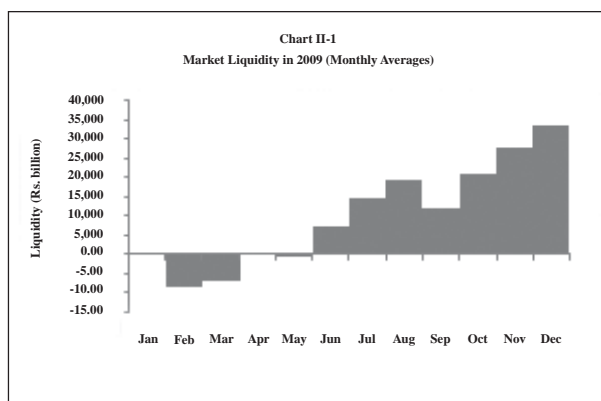
## 6. DOMESTIC OPERATIONS

The Domestic Operations Department (DOD) continued to perform its major functions of implementing the monetary policy of the CBSL mainly through Open Market Operations (OMO) and enforcing Statutory Reserve Requirement (SRR) and serving as the banker to both commercial banks and the government. The DOD also ensured, as an ancillary service, the availability of funds for settlements to be made under the Real Time Gross Settlement System (RTGS) by providing the Intra Day Liquidity Facility (ILF) to commercial banks and primary dealers to ensure the smooth functioning of country's electronic payment and settlement system.

### 6.1 Monetary Policy Implementation

Implementation of the monetary policy experienced an unprecedented challenge in 2009. Severe stress created by the world financial turmoil triggered capital outflows continued in the first quarter of the year. Action of the CBSL to provide the required foreign currency liquidity to contain excess volatility created a deficit in the rupee market liquidity. Quick and aggressive policy response by the CBSL in providing rupee liquidity to the market to address this situation was instrumental in containing the impact of liquidity shortage in the market. However, this trend was short-lived and reversed from the second quarter of 2009, particularly on the regained normalcy following conclusion of the internal conflict. With the near zero interest rates of major foreign currencies, yield rates of rupee denominated government securities have been viewed lucrative by large emerging market investors. Foreign currency inflows seeking investments in Sri Lanka Government Rupee Securities necessitated alternative instruments by the CBSL to absorb the resultant excess rupee liquidity in the market. Continuing foreign currency





inflows intensified the challenge on monetary policy operations with the CBSL running out of its entire stock of government securities (as much as Rs.220 bn. at the beginning of the second quarter) in its liquidity absorption exercise. With no government securities in hand for its liquidity absorption exercise, the CBSL re-introduced the issuance of its own securities, to meet the increasing market liquidity. However, the CBSL securities fail to offer the same flexibility as those offered by government securities, requiring a fresh look at the absorption instruments in use. As a result, the CBSL introduced foreign exchange (FX SWAPs) to absorb the excess liquidity. Irrespective of these non-conventional measures, high liquidity surplus in the rupee market continued unabated and reached its peak towards the end of the year.

Since the beginning of the year, the CBSL has gradually eased its monetary policy stance. Accordingly, the CBSL reduced the penal rate of interest charged on Reverse Repurchase (Reverse Repo) transactions by 600 basis points from 19 per cent to 13 per cent in four occasions and it was totally withdrawn in June 2009. The CBSL also lifted all the restrictions on access to Repurchase (Repo) and Reverse Repo standing facility by mid-2009 to maintain the inter-bank interest rates stable within the interest rate corridor. Consequently, the policy rate corridor was re-established. Subsequent period witnessed the lowering of policy interest rates, Repo Rates by 300 basis points from 10.50 per cent to 7.50 per cent and Reverse Repo rates by 225 basis points from 12 per cent to 9.75 per cent in several steps to support economic activities given the decline in inflation and inflation expectations. These steps were taken with a view to facilitate resurrection of commercial banks' lending activities by encouraging them to lend their surplus funds to customers rather than investing in low risk asset classes, including Repurchase Agreements of the CBSL.

Liquidity in the banking system, which was at a deficit during the first half of the year, gradually declined and turned into a surplus towards the end of the year (Chart II – 1). The market liquidity, which was a deficit of Rs. 5.0 bn. on average per day during the first quarter of 2009 improved and turned into a surplus of Rs.20 bn. during the

second half of the year. During the first half of 2009, funds were released to the market on an overnight basis through the Reverse Repo standing facility and on a permanent basis through the purchase of Treasury bills from Participating Institutions (PIs). At the same time, appropriate measures were taken to ensure the stability of banks by providing much needed liquidity during the period of global liquidity crunch, as and when required. Moreover, the Statutory Reserve Ratio (SRR) of commercial banks was further reduced by 75 basis points from 7.75 per cent to 7.00 per cent on 27 February to provide liquidity amounting to about Rs.9.0 bn. into the money market.

The absorption of market liquidity were conducted both on a temporary basis through overnight Repo transactions and a permanent basis through outright sales of Treasury bills held by the CBSL. Further, absorption was also continued on a relatively longer-term basis through term Repo transaction introduced in 2008. High market liquidity and continued liquidity absorption by the CBSL has evaporated almost the entire stock of Treasury bills held by the CBSL. Consequently, the CBSL has resorted to issue its own securities since October 2009. However, the high liquidity surplus was continued unabated and reached its peak in December. As a result, the CBSL introduced FX SWAPs to absorb the excess liquidity in the domestic market since November, 2009. Together with the existing CBSL Securities, FX SWAPs are expected to achieve improved efficiency and effectiveness in liquidity management operations. The CBSL has also established a framework for a securities borrowing program to borrow government securities from large holders of such securities. Securities borrowed under this scheme are expected to be used in the OMO to absorb excess liquidity in the market. These borrowings would be on an agreed fee decided on the basis of demand and supply of the respective securities. While facilitating the continued liquidity absorption exercise, such a scheme is expected to increase the efficiency of secondary market trading in the government securities by establishing a market for securities borrowing and lending. The CBSL is in the process of educating the participants on the new initiative.

## 6.2 Open Market Operations (OMO)

### (i) Auctions Under OMO

#### a. Overnight Repo Transactions

The DOD continued to conduct auctions for overnight Repo transactions to absorb liquidity surplus in the banking system on a daily basis. The excess liquidity recorded mainly during the second half of the year was absorbed through the daily auctions by selling Treasury bills on repurchase basis. Due to the inadequacy of Treasury bill holdings of the CBSL, the type of collateral was changed to CBSL securities since October 2009. On average about Rs. 12.2 bn. per day was offered over the year 2009 at the

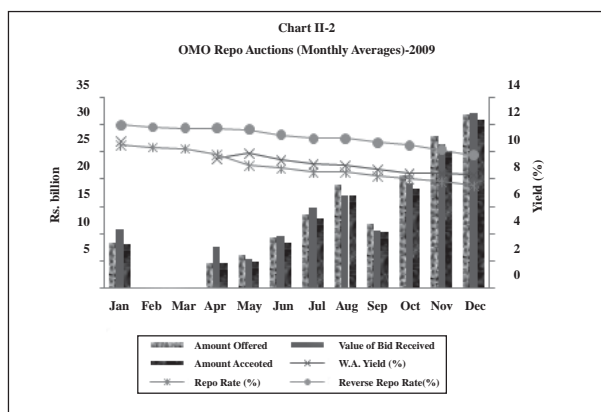
auction, whilst Rs. 11.1 bn. representing 89 per cent of estimated liquidity, was absorbed from the auction. The weighted average yield rate at the auctions depicted in Chart II – 2 gradually declined from 10.71 per cent from the beginning of the year to 8.50 per cent towards end of the year in line with the reduced policy interest rates of the CBSL. The weighted average yield rate lowered around the lower bound of the corridor (on average 90 basis points above the corridor) during the period.

### Term Repo Transactions

The DOD continued to conduct term repo auctions introduced in 2008 to sell Treasury bills as a strategy to absorb liquidity on a longer-term basis. The tenure of the term repo auction was from one week to one month, whilst the weighted average yield rate varied in the range of 8.13 per cent to 9.96 per cent.

### Reverse Repo Transactions

The DOD conducted only two Reverse Repo auctions to purchase Treasury bills and Treasury bonds on a reverse repurchase basis. On average, Rs.1.46 bn. was injected from the auction whilst weight average yield rate varied in the range of 10.56 per cent to 11.0 per cent.



### Term Reverse Repo Transactions

In March 2009, the DOD introduced the term Reverse Repo auction to buy Treasury bills and bonds as a strategy to inject liquidity on a relatively longer term basis, the period of the term reverse repo auction was varied in the range of 14 days to 30 days whilst weighted average yield rate varied between 11.93 per cent and 13.14 per cent.

#### (ii) Standing Facilities

The standing facilities continued as an avenue for those PIs, which were unable to manage their short-term liquidity requirements through the inter-bank money market and/or at the daily auctions under OMO. These facilities were provided at the Repo and Reverse Repo rates of the CBSL.

### Repo Transactions

The PIs, which were not successful or unable to participate at the Repo auctions and unable to use excess funds to lend in money market due to, self imposed risk limits of banks on their interbank operations, resorted to standing facilities at the Repo rate of the CBSL. From mid-March, whenever the CBSL offered Reverse Repo facility (RRF) at the reverse repurchase rate, the Repo facility available was limited to Rs.100 mn. per PI per day. This limitation was relaxed on 21 May 2009 in line with the increasing liquidity in the market. In 2009, Repo transactions under the standing facility were on average, about Rs 3.0 bn. per day, as the major portion of excess liquidity was absorbed through the OMO overnight Repo auction.

### Reverse Repo Transactions

The purpose of the CBSL's Reverse Repo facility (RRF) is to fulfill an urgent liquidity requirement of a participant, as a last resort, where access to alternative sources of funds is not available. As such, the CBSL attempted to strike a balance between discouraging the excessive use of the RRF and meeting the liquidity requirements of PIs. Accordingly, the CBSL provided the RRF, at the Reverse Repo penal rate, up to three times per calendar month per participant and beyond this limit at a penal rate of interest of 19 per cent per annum, with effect from 22nd February 2008, only on days when there was a liquidity shortfall in the system. The RRF at the penal rate was also made available on days when the system's liquidity was broadly in balance.

PIs extensively utilized the RRF under the standing facility especially during the first quarter of 2009 due to the substantial liquidity deficit prevailed in the banking system. The CBSL reduced the Reverse Repo penal rate by 600 basis points from 19 per cent to 13 per cent during the first quarter of 2009 and completely lifted in May. During the year, RRF granted at the Reverse Repo rate and the penal rate amounted to Rs. 228.9 bn. and Rs. 620.1 bn. respectively.

### Term Reverse Repo Transactions

The Term Reverse Repo facility up to one month maturity at an annualized compounded rate of interest comparable to the overnight Reverse Repo penal rate was provided under the standing facility from 15 January 2009. However, with the re-stabilization of the banking sector the utilization of this facility was minimal. The facilities granted during the year amounted to Rs.113.59 bn.

#### (iii) Issue of Central Bank Securities

In the absence of a sufficient volume of Treasury bill holdings, the CBSL issued its own securities (CBSL securities) both on an overnight basis and term basis to

absorb the surplus liquidity. The first auction to issue CBSL securities on overnight basis was held on 6 October 2009 and these securities were continuously used during rest of the year to absorb excess liquidity in the system.

On average, the CBSL securities worth of Rs. 27.56 bn. was offered at the auction during the year whilst Rs. 25.4 bn. representing 90.5 per cent of estimated liquidity was absorbed through the auction during this period. The weighted average yield rates of the auctions ranged between 8.23 per cent and 8.51 per cent during October to December, 2009. The CBSL securities were also issued on overnight basis under the standing facility at the Repo rate and the amount issued was on average, about Rs 2.1 bn. per day.

The DOD also conducted term auctions to issue CBSL securities, as a strategy to absorb liquidity on a longer term basis. The total amount issued was Rs. 169 bn. The period of the term auctions ranged from 14 to 91 days, whilst the weighted average yield rates varied from 8.10 per cent to 9.62 per cent.

#### (iv) Outright Transactions

The CBSL conducted outright auctions to sell Treasury bills out of its own portfolio, in order to absorb excess liquidity on a permanent basis. The total value of Treasury bills sold through outright auction sales amounted to Rs. 70.26 bn. The tenure of the Treasury bills sold was ranging from 14 days to 53 days, whilst the yield rates were ranged from 8.1 per cent to 17.1 per cent.

#### (v) FX SWAP Transactions

The Department introduced FX SWAPs as an instrument for absorbing (injecting) excess (short) liquidity in the market on 4 November 2009. This has gained popularity among market participants and traded at a substantial discount to the domestic and foreign interest rate differential. The total amount of excess liquidity absorbed through these transactions was Rs. 57.5 billion (US dollars 502 million).

#### (b) Statutory Reserve Requirement (SRR)

The DOD is responsible for enforcing the SRR as a monetary policy instrument. The prolonged liquidity shortage in the banking system was aggravated due to the CBSL's injection of foreign currency to meet the demand in the domestic market. In order to address the issue, the CBSL initiated measures to inject additional rupee liquidity on a permanent basis. This was further facilitated by reducing the SRR. Accordingly, the SRR, which had been reduced two times up to 7.75 per cent in 2008, was reduced further by 75 basis points to 7 per cent of deposit liabilities, with effect from 27 February 2009. The resultant release of added liquidity to the market was about Rs. 9.0 bn.

#### (c) Bank Rate

The CBSL's rate of interest (bank rate) on short-term advances to licensed commercial banks, stipulated under Section 87 of the Monetary Law Act, remained unchanged at 15 per cent. However, this rate was inoperative as no bank resorted to borrowing from the CBSL at the bank rate.

### 6.3 Functioning as Banker to commercial banks and the government

#### 6.3.1 Accounts of Financial Institutions

The DOD provided current account facilities to commercial banks and primary dealers, to ensure an efficient interbank payment and settlement system, thus facilitating the CBSL's role of being the banker to commercial banks. As at end of 2009, CBSL maintained accounts for 22 commercial banks and 9 primary dealers. These accounts were operated on a Real Time Gross Settlement (RTGS) basis within the automated general ledger system of the CBSL.

#### 6.3.2 Government Accounts

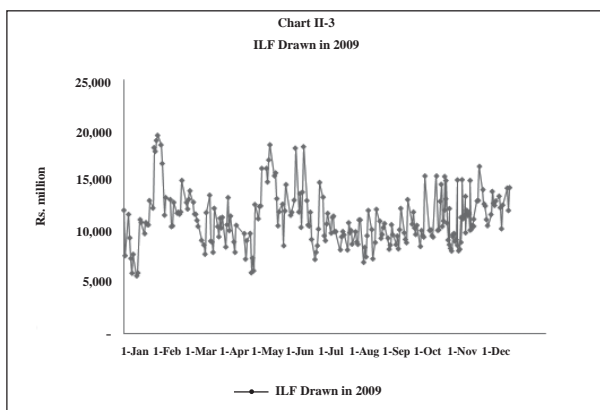
The DOD also maintained the accounts of government departments, government agencies and institutions and certain statutory boards, providing them with required banking facilities, in functioning as the banker to the government. The total number of accounts maintained by the CBSL amounted to 54 as at end 2009, with six new accounts being opened and four being closed at the request of the government. In terms of Section 89 of the Monetary Law Act, the CBSL provides provisional advances to the government free of charge, with the limit on such advances being 10 per cent of the estimated government revenue. During 2009, the value of the provisional advance was increased by Rs. 10.65 bn. to Rs. 87.82 bn.

#### 6.4 Provision of Intra Day Liquidity Facility (ILF)

The DOD ensured the smooth and efficient functioning of the RTGS system by providing ILF to commercial banks and primary dealers. This facility was provided free of charge against the collateral of Treasury bills and bonds, which were valued at their current market prices with a sufficient hair cut added to cover for any variations in prices during the day.

The total value and average daily value of ILF drawn during the year amounted to Rs. 2,725 bn. and Rs. 11.3 bn. respectively (Chart II – 3) while the corresponding figures for the previous year were Rs. 2,186 bn. and Rs. 9.07 bn. The main reason for the increased drawing of ILF was the demand by the primary dealers to facilitate the settlement of Treasury bills purchased through the primary auctions. Implementing strict measures, such as the penalty interest at the bank rate and the suspension of the facility for repeated defaults have ensured the prompt reversal of ILF before the close of business of LankaSettle.

As a consequence, there were no ILF defaults during the year.



## 7. ECONOMIC RESEARCH

The Economic Research Department (ERD) discharged its statutory responsibilities amidst a challenging domestic and international environment in 2009. In fulfilling its responsibilities, the ERD continued to engage in conducting policy related research while compiling and analysing statistical as well as other information on the performance of the economy of Sri Lanka, in the context of global economic developments. In doing so, the ERD assisted the management of the CBSL and the Monetary Board to formulate monetary policy and discharge the CBSL's responsibilities as the economic advisor to the government. The ERD continued to provide policy recommendations to other departments of the CBSL and to various outside agencies and institutions. The ERD also ensured the continuous dissemination of information on economic and financial developments in Sri Lanka through media, in a timely manner, for the benefit of the general public.

### 7.1 Conducting Research for Assisting Monetary Policy Formulation

The efforts of the ERD were primarily focused on undertaking evidence based research and preparing comprehensive reports to guide the formulation and implementation of monetary policy, in line with broad macroeconomic objectives of the country. In particular, these endeavours were directed towards facilitating the deliberations of the Monetary Policy Committee (MPC), which makes recommendations in relation to monetary policy for the consideration of the Monetary Board. Furthermore, regular updates on the state of the economy were submitted to the Monetary Board by the ERD to keep the Monetary Board informed of the latest developments in the economy.

The econometric modelling framework of ERD for forecasting inflation in Sri Lanka, which was developed in

2008, was further improved in 2009, as a credible forecast of inflation was of utmost importance in conducting monetary policy effectively. Furthermore, given that monetary policy has to be guided by the trends in underlying inflation, a proper measure of core inflation is imperative, a series of alternative measures of core inflation, compiled according to different methodologies, were prepared by the ERD in 2009. A new measure of core inflation, selected from the series of alternative measures compiled in 2009, has already been approved by the Monetary Board, and is expected to be published by the Department of Census and Statistics (DCS) in 2010, replacing the currently published measure of core inflation.

The ERD co-ordinated the second international research conference on "Central Banking and Financial Markets" with a view to sharing research outcomes with regional central banks and policy makers. The staff of the ERD also engaged in conducting joint research with international organisations, such as the SEACEN Centre. Moreover, the weekly discussion series continued within the ERD to discuss topical issues, with the participation of the entire staff of the ERD. Meanwhile, a number of presentations on various economic issues were prepared by the ERD for the Governor and the senior management of the Bank.

In view of fostering research on subjects of contemporary importance, following research papers, completed in 2009 by the Bank's staff, were published in the Staff Studies, Volume 39, Nos. 1 & 2 of 2009.

- "The Main Determinants of Inflation in Sri Lanka: A VAR Based Analysis" by Mr. H.P.G.S.Ratnasiri
- "Interest Rates as a Policy Instrument: Recent Experience of Sri Lanka" by Dr. W.M. Hemachandra
- "A Regional Analysis of Credit Needs and the Unmet Demand for Microfinance" by Ms. A.S. De Alwis
- "Bilateral J-curve between Sri Lanka and its major Trading Partners" by Ms. W.T.K.Perera

The ERD co-ordinated the meetings of the Monetary Policy Consultative Committee (MPCC), which was established to enhance the dialogue between the Bank and representatives of private sector entities, in order to strengthen the monetary policy decision making process. The MPCC comprised of Prof. A. D. V. de S. Indraratne (Chairman), Mr. Sohli Captain, Mr. Yohan Perera, Mr. Mahen Dayananda, Mr. R. M. B. Senanayake, Mr. M. P. Jayawardena, Mr. Cubby Wijetunge and Dr. G. Uswattearachchi. During the year, the MPCC met on a monthly basis to review economic developments and thereby made a significant contribution to the policy discussions at the CBSL.

During the year, the ERD conducted a number of surveys, including the Factory Industry Survey and the Survey on Housing Approvals in the Greater Colombo Area, to identify the performance, outlook and issues in respect of relevant sectors. Furthermore, several meetings with the participation of representatives from various sectors in the economy were organised to discuss topical issues and difficulties faced by them due to the global financial crisis and the consequent recession in the global economy, as well as the new opportunities that have been created with the ending of the decades long internal conflict.

### **7.2 Provision of Policy Advice to the Government**

In providing proactive policy advice to the government, the ERD submitted several policy papers to the Monetary Board. The ERD continued to evaluate the terms and conditions of all foreign loans obtained by the government from multilateral and bilateral sources, as well as commercial sources. Board papers were presented to the Monetary Board on monetary implications of such loans and recommendations made, on the basis of evaluations. The ERD also continued to provide its independent views on Cabinet papers, which have important economic implications.

### **7.3 Preparation of Statutory Reports and other Reports/Publications**

Preparation of statutory and other reports of the CBSL is a primary responsibility of the ERD. The activities relating to the publication of the CBSL's Annual Report for 2008, Recent Economic Developments – Highlights of 2009 and Prospects for 2010, and the monthly Bulletins were coordinated by the Department in 2009. The ERD also prepared the report under Section 116(1) of the Monetary Law Act (September 15th Report). Further, the ERD continued to issue regular press releases on monetary policy, balance of payments and international trade, to disseminate information to the public on the developments in respect of key sectors in the economy. In addition, the ERD prepared a booklet titled "Sri Lanka – A New Era" for the purpose of awareness of international investors on the post conflict investment opportunities available in Sri Lanka.

The ERD prepared the public policy statement of the CBSL, the "Road Map for Monetary and Financial Sector Policies for 2009 and Beyond", which was announced to the public on 02 January 2009. The 'Road Map' contained the targets set by the CBSL for the year 2009 in relation to monetary and financial system stability. It also contains an analysis of the developments in the economy, and the conduct of monetary policy as well as policies in respect

of the financial sector, in 2009. Further, it discusses the challenges to achieving the targets for 2009. The 'Road Map' is published with a view to enhancing the predictability and transparency of the CBSL policies, which would help the stakeholders to formulate and better calibrate their own plans and strategies for the period ahead. For the fourth consecutive year, a similar policy statement was prepared for 2010, and this was announced on 04 January 2010.

### **7.4 Contribution to Knowledge Enhancement and Sharing of Expertise**

The ERD continued to provide its expertise to improve the knowledge of economics, both within and outside the CBSL. Officials from the ERD continued to serve as resource persons at numerous fora including educational programmes conducted by the Centre for Banking Studies (CBS) and educational establishments such as schools. They also made presentations on central banking as well as macroeconomic developments to various delegations that visited the country. Meanwhile, senior officers of ERD assisted post-graduate degree aspirants of the CBSL, guided them on research proposals and research papers.

Senior officials from the ERD continued to serve as members of a number of internal and external committees and boards. These included the Board of Investment of Sri Lanka (BOI), National Higher Education Management Information System (NHEMIS), Management Committee (HMC) at the Ministry of Higher Education, Committee on the Refurbishment of M7 Class Locomotives, National Council for Economic Development (NCED), Presidential Task Force on Renewable Energy, Finance Commission Steering Committee on Promoting Provincial Growth for Eliminating Inter-regional Imbalances, Working Group on Policy Advocacy at the National Enterprise Development Authority, National Committee on Socio Economics and Policy Analysis at the Sri Lanka Council for Agricultural Research and Policy, International Labour Organisation Committee on Analysing Labour and Social Trends in Sri Lanka - 2009, Economic Review Advisory Committee (ERAC) of the People's Bank, Steering Committee on Healthcare Financing, Steering Committee on National Health Accounts and Financial Sector Monitoring Committee at the Treasury. Officials from the ERD participated at various other meetings too, including that of the National Economic Council and Food Security and Cost of Living Committee, and assisted in the decision making process of such committees.

### **7.5 International Relations**

The ERD, on behalf of the CBSL and the government, continued to coordinate with multilateral organisations

such as the IMF, World Bank and SEACEN, on a regular basis. The ERD also continued to work closely with international sovereign rating agencies, namely, Fitch Ratings and S&P Ratings Services. During 2009, the ERD coordinated the work relating to five visits of IMF staff missions to Sri Lanka. The ERD was primarily responsible for coordinating the work relating to the IMF-SBA facility. The ERD also extended its assistance to the Ministry of Finance and Planning in coordinating its activities with the World Bank, Asian Development Bank and various other multilateral and bilateral development partners. Furthermore, the ERD provided information to prepare country briefs to be presented at various international fora such as the Non-Aligned Movement (NAM) Summit, G-15 Meetings, and United Nations Conference on Global Financial Crisis. The ERD also provided macro-economic analysis and feedback on draft statements issued at the conclusion of these fora, to the relevant organisations.

## 8. EMPLOYEES' PROVIDENT FUND (EPF)

In terms of the Employees' Provident Fund (EPF) Act No.15 of 1958, the Monetary Board is the custodian of the Employees' Provident Fund and is entrusted with the powers, duties and functions in respect of the management of the Fund. The operations of the EPF Department facilitate the Monetary Board to perform its custodian powers, duties and functions as per the provisions of the EPF Act. Accordingly, EPF Department is engaged in collection of member-contributions and surcharges, maintenance of member-accounts, investment of surplus funds, charging the expenditure incurred by the Monetary Board and Commissioner of Labour in the performance of their duties and functions under the EPF Act to the income of the Fund, payment of benefits to beneficiaries of the Fund, crediting interest to member accounts and compilation of financial statements of the Fund and submission of such statements to the Hon. Minister of Labour within three months from end December each year. The EPF Department performed the aforementioned activities during 2009 in terms of the policies and decisions approved by the Monetary Board and in close co-ordination with the Commissioner of Labour.

### 8.1 Membership, Member Balances and Refunds

The total number of member-accounts marginally increased to 12.7 million by end 2009 from 12.5 million as at end 2008. The number of contributing member accounts stood at 2.0 million by end 2009 compared to that of 2.3 million by end 2008. Meanwhile, the number of contributing employers by end of 2009 was 60,000 which

was a decrease of 4.2 per cent compared to that of 62,625 by end 2008. As at end 2009, the Fund (i.e., total liability to the members) stood at Rs. 752.2 billion recording a sharp increase of 16.6 per cent from that of Rs. 645 billion as at end 2008 (Table II-1). The increase in both the income of the fund and contributions received on their behalf enabled the growth of the Fund during the year. The total amount of refunds to the members and their legal heirs in 2009 was Rs. 31.9 billion, which is an increase of 23.0 per cent from that of Rs. 25.9 billion in 2008. Compared to the preceding year, the number of refund applications processed increased by 5.4 per cent to 108,066 applications during 2009. The net contributions (contributions less refunds of benefits) amounted to Rs. 16.8 billion during the year compared with that of Rs. 20 billion in 2008.

**Table II-1**  
**Selected Key Information of the Fund**

| Item                                  | 2008    | 2009 (a) | change (%) |
|---------------------------------------|---------|----------|------------|
| Total number of member accounts (mn)  | 12.46   | 12.68    | 1.8        |
| Contributing member accounts (mn)     | 2.3     | 2.0      | (13.0)     |
| Non-contributing member accounts (mn) | 10.16   | 10.68    | 5.0        |
| Contributing employers                | 62,625  | 60,000   | (4.2)      |
| Total contributions (Rs.mn)           | 45,951  | 48,712   | 6.0        |
| Total refunds (Rs. mn)                | 25,931  | 31,901   | 23.0       |
| Number of refunds                     | 102,496 | 108,066  | 5.4        |
| Total liability to members (Rs.bn)    | 645.0   | 752.2    | 16.6       |
| Total value of the Fund (Rs.bn)       | 653.2   | 769.4    | 17.8       |

(a) Provisional.

Source : Employees' Provident Fund.

### 8.2 Investment of Funds and Returns

(i) **Investment Portfolio:** The Fund's investment policy continued to be focused on long-term positive rate of real return to the members ensuring the safety of the Fund while maintaining an adequate liquidity for refund payments and meeting other expenditure commitments. As at end 2009, the total investment portfolio of the Fund stood at Rs.737.1 billion reflecting a 17.5 per cent growth compared to that of Rs. 627.3 billion as at end 2008 (Table II-2). Of this total 97.1 per cent was in government securities while 2.4 per cent was in corporate debentures and equities. The balance 0.5 per cent was invested in high liquid assets such as reverse-repos on government securities to maintain liquidity.

**Table II-2**  
**Investment Portfolio**

| Type of Investment        | 2008         |            | 2009         |            |
|---------------------------|--------------|------------|--------------|------------|
|                           | Rs.bn        | Share%     | Rs.bn        | Share%     |
| Treasury bonds and bills  | 539.6        | 86.0       | 658.9        | 89.4       |
| Rupee Loans to Government | 68.5         | 10.9       | 56.6         | 7.7        |
| Corporate Debentures      | 8.8          | 1.4        | 8.3          | 1.1        |
| Equity                    | 6.9          | 1.1        | 9.8          | 1.3        |
| Reverse Repos             | 3.5          | 0.6        | 3.5          | 0.5        |
| <b>Total</b>              | <b>627.3</b> | <b>100</b> | <b>737.1</b> | <b>100</b> |

Source : Employees' Provident Fund

(ii) **Revenue:** In 2009, the gross income of the Fund increased by 37.9 per cent to Rs. 109.6 billion from Rs. 79.5 billion in 2008. As in the past, the interest income including amortization gain was the major source of income (97.7 per cent of the income) to the Fund. During 2009, the interest income including amortization gain grew by Rs. 28.2 billion to Rs. 107.1 billion compared to that of Rs. 78.9 billion in 2008 (Table II-3). As 97.1 per cent of the funds were invested in government securities at different interest rates and maturity periods, the total return on investment was highly correlated with yields and maturity profile of the government securities portfolio. As at end 2009, the weighted average rate of return on government securities held by the Fund was 14.98 per cent and the yields of those securities varied between 12.60 per cent and 16.61 per cent depending on their maturity (Table II-4). The capital gains and dividends realized from equity portfolio increased significantly by 54.6 per cent to Rs. 347.8 million in 2009 from Rs. 225 million in 2008 mainly due to improvement in the equity market during the second half of the year (Table II-3). Accordingly, the rate of return on the average equity portfolio stood at 8.6 per cent as against 3.8 per cent in 2008. Overall, the rate of return on total portfolio increased to 16 per cent in 2009 from 13.8 per cent in 2008.

**Table II-3**  
**Income on Investments**

| Source of Income                                       | 2008          |            | 2009           |            |
|--|---------------|------------|----------------|------------|
|  | Rs.mn         | Share %    | Rs.mn          | Share %    |
| Interest   | 61,445        | 77.3       | 79,810         | 72.8       |
| Amortized gain   | 17,504        | 22.0       | 27,337         | 24.9       |
| Capital gain from Government Securities <sup>(a)</sup> | 24            | 0.03       | 1,920          | 1.8        |
| Capital gain from Equity <sup>(a)</sup>                | 30            | 0.07       | 235            | 0.2        |
| Dividends  | 153           | 0.2        | 133            | 0.1        |
| Other  | 307           | 0.4        | 182            | 0.2        |
| <b>Total</b>   | <b>79,463</b> | <b>100</b> | <b>109,617</b> | <b>100</b> |

(a) Including Mark-to Market Gain

Source : Employees' Provident Fund

**Table II-4**  
**Maturity Profile of Government Securities Portfolio - End of 2009**

| Maturity          | Amount Rs. mn  | % Share      | Weighted Average Yield (%) |
|-------------------|----------------|--------------|----------------------------|
| Less than 1 year  | 120,963        | 15.6         | 15.85                      |
| 1-2 years         | 324,574        | 41.8         | 16.61                      |
| 3-4 years         | 209,061        | 27.0         | 13.34                      |
| More than 4 years | 121,122        | 15.6         | 12.60                      |
| <b>Total</b>      | <b>775,720</b> | <b>100.0</b> | <b>14.98</b>               |

Source : Employees' Provident Fund

(iii) **Expenses:** Total operational expenditure of the Fund rose by 19.8 per cent to Rs. 763 million in 2009 from Rs. 637 million in 2008 (Table II-5). The Fund managed to maintain its total operational expenditure at 0.7 per cent of its total gross income in 2009. Maintaining operational expenditure below 1 per cent of the gross income has been a key feature of the Fund over the past several years.

**Table II-5**  
**Operational Expenditure**

| Item  | 2008 Rs. mn  | 2009(a) Rs.mn | Change %     |
|---|--------------|---------------|--------------|
| Personnel Expenses                            | 323.1        | 370.2         | 14.6         |
| Administrative Expenses                       | 289.0        | 357.0         | 23.5         |
| Other Expenses                                | 24.7         | 35.9          | 45.3         |
| <b>Total</b>                                  | <b>636.8</b> | <b>763.1</b>  | <b>19.8</b>  |
| <b>Total Expenses as a % of Gross Revenue</b> | <b>0.8</b>   | <b>0.7</b>    | <b>(0.1)</b> |

Source : Employees' Provident Fund

### 8.3 Payment of Interest on Member Balances

In 2009, a sum of Rs. 90,709 million was available for distribution as interest to the members of the Fund (Table II-6). Accordingly, interest payments to the member balances stood at a rate of 13.75 per cent on total member balances. This is an increase of 55 basis points compared to that of 13.20 per cent in the preceding year. This was the highest rate of interest declared ever since the inception of the Fund which was a result of the high interest rates that prevailed during 2008 and in the 1st half of 2009 (Table II-7). Since interest is paid on the year-end balance for the full year, the Effective Interest Rate (EIR)<sup>1</sup> is estimated at 13.92 per cent.

### 8.4 Member-Account Statements

The member-account statements for the first half of 2009 were issued to members through their employers during December 2009. Arrangements have been made to issue account statements for the second half of 2009 by end of July 2010.

**Table II-6**  
**Payment of Interest to Members**

| Item   | 2008<br>Rs. mn | 2009<br>Rs. mn | Change<br>% |
|--|----------------|----------------|-------------|
| Gross revenue  | 79,463         | 109,617        | 37.9        |
| Total operating expenses   | 637            | 763            | 19.8        |
| Income tax   | 5,426          | 7,604          | 40.1        |
| Net income available for distribution  | 73,618         | 101,690        | 38.1        |
| Interest paid on current refunds   | 1,152          | 1,656          | 43.7        |
| Net income available for distribution (after payment of interest on current refunds) | 72,466         | 100,034        | 38.0        |
| Transfers from /(to) reserves  | 3,000          | (9,325)        | (410.8)     |
| Net income available for distribution after transferring from / (to) reserves        | 75,466         | 90,709         | 20.2        |
| Interest paid on member balances   | 75,027         | 90,691         | 20.9        |
| Carry forward balance  | 439            | 18             | (95.9)      |
| Interest rate paid on member balances %  | 13.2           | 13.75          | 0.55        |

Source : Employees' Provident Fund

**Table II-7**  
**Interest Rate Paid on Member Balances**

| Year | Interest Rate Paid (%) | Effective Interest Rate (%) |
|------|------------------------|-----------------------------|
| 2000 | 11.50                  | 11.69                       |
| 2001 | 11.50                  | 11.69                       |
| 2002 | 12.10                  | 12.26                       |
| 2003 | 12.00                  | 12.07                       |
| 2004 | 9.50                   | 9.59                        |
| 2005 | 9.00                   | 9.13                        |
| 2006 | 10.10                  | 10.30                       |
| 2007 | 11.20                  | 11.40                       |
| 2008 | 13.20                  | 13.40                       |
| 2009 | 13.75                  | 13.92                       |

Source : Employees' Provident Fund

### 8.5 Housing Loan Facility

In 1988, the Fund introduced a Housing Loan Scheme by facilitating the members to obtain housing loans from 6 participating lending institutions, viz., Bank of Ceylon, People's Bank, State Mortgage and Investment Bank, HDFC Bank, Co-operative Rural Banks and National Housing Development Authority. The Fund continued to issue certificates of guarantees to members as against their member balances under this Scheme. In 2009, the EPF Department issued 10,383 member-balance certificates to the participating lending institutions for the approval

$1 \text{ EIR} = (\text{Interest paid to Members}) / [(\text{Beginning of the year member balances} + \text{Year end member balances}) / 2]$

of housing loans amounting to Rs. 2,680 million (Table II-8). Further, nearly Rs.1,551.8 million was deducted from relevant member accounts and was remitted to the participating lending institutions to settle the loans in arrears for the year 2009.

**Table II-8**  
**Housing Loan Facility**

| Year         | Certificates Issued (No) | Credit Approved (Rs.mn) | Amount Remitted to Lending Institutions (Rs.mn) |
|--------------|--------------------------|-------------------------|---|
| 2000         | 12,938                   | 1,648                   | 262   |
| 2001         | 16,066                   | 2,091                   | 381   |
| 2002         | 19,502                   | 2,673                   | 541   |
| 2003         | 18,689                   | 2,792                   | 670   |
| 2004         | 14,307                   | 2,452                   | 735   |
| 2005         | 14,600                   | 2,766                   | 900   |
| 2006         | 15,136                   | 3,049                   | 1,078   |
| 2007         | 12,969                   | 2,872                   | 1,240   |
| 2008         | 12,519                   | 3,008                   | 1,192   |
| 2009 (a)     | 10,383                   | 2,680                   | 1,552   |
| <b>Total</b> | <b>147,109</b>           | <b>26,031</b>           | <b>8,551</b>                                    |

(a)Provisional

Source : Employees' Provident Fund

### 8.6 Public Awareness

As in the past, the Fund continued its public awareness programmes during 2009. Accordingly, EPF Department conducted 13 awareness programmes mainly for the purpose of collection of member information through electronic media and re-registration of members. Further, 5 mobile services, including 2 public exhibitions (Deyata Kirula and HR Service Providers' Exhibition), were conducted by the EPF Department. Meanwhile, three press advertisements were published to inform the members of the issue of half-yearly Member Account Statements.

### 8.7 Systems Development

During 2009, the EPF Department initiated and completed approximately 40 per cent of the work for the 3rd phase of the EPF website, with the technical support of the CBSL's IT Department. The main aim of this 3rd phase was to collect contributions and member information via the EPF website. In the year under review, EPF Department registered 1,033 members for its SMS/web information service, enabling them to access information such as account balance inquiry, current contribution details, status of the refund applications and housing loan applications through Internet and Short Message Service. The Re-registration Project of the Fund would enable it to develop a more secured, on-line member account system, which will enhance the efficiency of the member services and the management of the Fund.

### 8.8 Re-registration of Members

The Re-registration Project is a joint project between the EPF Department and Labour Department, which



is being undertaken with the intention of moving to a fully IT based member accounts and fund management system. Under this project, all the members of the Fund will be re-registered by their names as appearing in the National Identity Card (NIC) and the NIC numbers will be assigned to the relevant member accounts to facilitate amalgamation of their previous member accounts. The thumb impressions of the members will be taken in digital form as an advanced safety measure of record keeping. As at end of 2009, EPF Department completed 70 per cent of the work relating to assigning of unique member numbers to the contributing C category employees (i.e., employees of the organizations where less than 150 people are employed). The balance 30 per cent work is expected to be completed within the first quarter of 2010. Further, the EPF Department commenced assigning of unique member numbers to the active C3 category members (i.e., employees of the organizations where 150 or more people are employed) during 2009.

## 9. EXCHANGE CONTROL

The Exchange Control Department (ECD) carries out the exchange control function of the CBSL as the agent of the government in administering the provisions of the Exchange Control Act No. 24 of 1953 as amended. Accordingly, the major activities of the ECD during the year 2009 included issuance of Directions/Operating Instructions to authorized dealers and others dealing in foreign exchange, granting approvals for foreign exchange transactions, surveillance on various foreign exchange transactions and investigations into violations of the provisions of the Exchange Control Act.

During the year 2009, measures were taken to rationalize foreign exchange transactions with further liberalization and to promote international investor confidence.

### 9.1 Issuance of new Directions/Operating Instructions.

The ECD issued several new Directions/Operating Instructions to authorized dealers (licensed commercial banks) and others dealing in foreign exchange in 2009.

A summary of such Directions/Operating Instructions is as follows: (Details of these Directions/Operating Instructions are given in Part III of this report.)

- (a) **Permission for investment in Rupee Denominated Treasury bonds and Treasury bills by Sri Lankan diaspora and migrant workforce:** Sri Lankans living abroad including migrant workers/businessmen; Sri Lankan professionals living in Sri Lanka and abroad who earn foreign exchange, Sri Lankan citizens with dual citizenship irrespective of their country of residence and banks acting in fiduciary capacity on behalf of the above categories, were permitted to purchase, hold and sell Rupee

denominated Treasury bonds (T-bonds) and Treasury bills (T-bills) through a special rupee account named **“Treasury bonds/bills Investment External Rupee Account - Deshabhimani (TIERA – D)”**, provided that all such investments in aggregate do not exceed 10 per cent of the total value of T-bonds/T-bills outstanding at any given point of time.

- (b) **Payment of a bonus interest in rupees on the interest on Resident Foreign Currency (RFC) accounts and Non Resident Foreign Currency (NRFC) accounts:** Permission was granted to pay a bonus interest in Sri Lanka rupees on the interest paid by Authorized Dealers on RFC and NRFC accounts with effect from 01 February 2009.

A sum of Rs. 779.5 million has been paid as bonus interest to RFC and NRFC account holders during 2009.

This scheme was withdrawn on 01 October 2009 with the increase in foreign reserves of the country.

- (c) **Non Resident Foreign Currency (NRFC) Accounts:** New Zealand dollar was added to the list of designated foreign currencies and the Deutsch Mark, French Franc and the Netherlands Guilder have been removed from the list.
- (d) **Acquisition of dual citizenship of Sri Lanka:** Permission was granted to amalgamate funds in the Non Resident Foreign Currency (NRFC) Accounts, Resident Foreign Currency (RFC) Accounts, Special Foreign Investment Deposit Accounts (SFIDA), Foreign Currency Fixed Deposits Accounts for dual citizenship applicants and investments in Treasury bonds of ex-Sri Lankans holding foreign citizenship who have opened/are willing to open above foreign currency accounts and who have invested/are willing to invest in Treasury bonds, for the purpose of fulfilling the eligibility criteria for dual citizenship.

### 9.2 Issuance of government notifications:

The Minister of Finance and Planning granted permission by Order made under Section 17 of the Exchange Control Act (Chapter 423), to persons resident in Sri Lanka and bodies of persons incorporated in Sri Lanka, who earn or have earned foreign currency, to acquire, hold and transfer in the secondary market, international sovereign bonds issued by the government of Sri Lanka in years 2007 and 2009, subject to the directions issued by the Minister of Finance and Planning from time to time.

### 9.3 Approval for investment abroad and foreign borrowing:

The ECD processed 70 requests for approval of investments abroad and borrowings from abroad and granted approvals

for 39 requests highlighted below in terms of the relevant provisions of the Exchange Control Act.

- (a) Approvals for 25 resident companies to invest abroad amounting to US dollars 84.51 million, mainly in the areas of investment banking, trading, freight forwarding, retail operations and hotel industry;
- (b) Approvals for 14 resident companies to borrow from abroad a sum of approximately US dollars 62.05 million.

#### **9.4 Issuance of permits / licences to freight forwarders, money changers and restricted dealers**

The ECD continued to issue permits to freight forwarders, money changers and other restricted dealers as indicated below:

- (a) Twenty four new companies were registered as freight forwarders, bringing the total number of freight forwarders to 301 at the end of 2009;
- (b) Eight new money changer licences were issued and 03 licences were withdrawn bringing the total number of money changers to 75. Further, 14 money changers who were successful in purchasing foreign currency over US dollars 4 million per annum were permitted to sell foreign currency. The required minimum annual turnover for the renewal of a money changing permit has been increased from US dollars 600,000 to US dollars 1 million with effect from 01 January 2010.
- (c) Forty seven new permits were issued to other restricted dealers, such as duty free shops, tourist hotels, tourist restaurants, travel agents and gem and jewellery shops bringing the total number of such restricted dealers to 747.

#### **9.5 Surveillance on foreign exchange transactions**

The ECD continued to strengthen its surveillance on foreign exchange transactions reported by relevant parties such as authorized dealers, restricted dealers and money changers with a view to promoting greater market discipline.

The information reported included sales and purchases of foreign exchange transactions through electronic fund transfer cards and several types of permitted foreign currency accounts schemes. Web-based reporting system enables the ECD to develop an on-line monitoring mechanism to assess the extent of foreign exchange flows.

#### **9.6 Investigations into Violations of the Provisions of the Exchange Control Act**

In order to ensure the orderly function of the market participants in foreign exchange transactions and the efficiency of the foreign exchange market, investigations were conducted into the non-compliance with the directions issued under the Exchange Control Act and contravention of the provisions of the said Act by the dealers in foreign exchange and various other parties.

Accordingly, during the year 2009, 121 investigations were concluded and Rs. 17,552,311.08 was collected as the penalties imposed on the offenders. Most of such investigations were linked to unauthorized acceptance and purchases of foreign currency, issuing securities to non-residents in contravention of the procedure laid down in the general permission granted under the Exchange Control Act and unauthorized payment of foreign currency to non-residents by the persons resident in Sri Lanka.

#### **9.7 Other activities - awareness on worker remittances**

In continuation of efforts to promote worker remittances through the banking and other formal channels in various ways, a one-day awareness programme was conducted for 320 prospective migrant workers in Matara in association with Sri Lanka Bureau of Foreign Employment and banks. At this programme, most of the prospective migrant workers were able to resolve their problems relating to foreign currency remittances.

### **10. FINANCIAL INTELLIGENCE UNIT**

The Financial Intelligence Unit (FIU) continued its operations in 2009 in terms of the statutory provisions of the Financial Transactions Reporting Act (FTRA) No. 6 of 2006. The main functions of the FIU includes collection and receipt of information on financial transactions that may relate to money laundering, terrorist financing and other unlawful activities defined in the FTRA, conducting investigations into suspicious financial transactions, dissemination of information and details of investigations to relevant regulatory and law enforcement authorities to institute legal/enforcement actions, issue of directives/regulations on Know Your Customer and Customer Due Diligence (KYC/CDD) and suspicious transactions to prevent offences covered in relevant statute. The highlights of main operations of the FIU during 2009 are as follows.

#### **10.1 Collection of information and investigations**

As in the previous year, under the requirements imposed by the FIU, licensed commercial banks (LCBs), licensed specialised banks (LSBs), registered finance companies (RFCs), stock brokering firms (SBs) and insurance companies (ICs) continued to report cash transactions and electronic funds transfers (inward and outwards) subject to the specified reporting threshold of Rs.1 million and above or its equivalent in foreign currencies .

The "LankaFIN," the IT System designed to analyse information/data reported by reporting institutions was expanded using a web based interface and permitted the LCBs, LSBs and RFCs to submit data on cash transactions, electronic fund transfers and suspicious transactions online to the FIU with effect from 1 July and 1 December 2009, respectively. The FIU continued to analyse the information/data reported by the reporting institutions by using the LankaFIN system and it also enabled the FIU to scrutinize over 1.6 million transactions during the year and to examine 272 suspicious transactions. In addition, the reporting institutions have submitted reports on 111 suspicious transactions. After conducting preliminary investigations, 31 and 8 suspicious transactions were referred to the law enforcement agencies and regulatory authorities, respectively for further investigation. Criminal Investigations Department (CID) is currently engaged in investigation of the cases referred to law enforcement agencies.

### 10.2 Issue of Directions/Regulations and implementation

The FIU issued the following Rules/Directions to the reporting institutions and these are given in detail in Part III of this Report.

- i. Circular to ensure the compliance with the Section 2 of the FTRA was issued to LCBs, LSBs and RFCs.
- ii. Circular on inclusion of Tamil Foundation among the list of terrorist organizations of the USA was issued to licensed banks. All licensed banks were informed to monitor and report details of remittances facilitated/to be facilitated by Tamil Foundation.
- iii. Circular to Director General of Board of Insurance of Sri Lanka was issued to strengthen and streamlining the good governance on AML/CFT of the insurance companies.

### 10.3 Other Activities

- i. **Signing of Memorandum of Understanding (MOUs) :** Four MOUs were signed in 2009 with the Indonesian Financial Transaction Reports and Analysis Center, The Anti-Money Laundering Council of the Republic of the Philippines, the Financial Information Unit of Nepal Rastra Bank and the Financial Intelligence Unit of National Bank of Cambodia for exchanging of information relating to Financial Intelligence and suspicious transactions.
- ii. **Institutional capacity building and awareness programmes :** Twelve training and awareness programmes were conducted in Western and Central Provinces during the year accommodating more than 1,500 participants representing LCBs, LSBs, RFCs, Police Department, educational institutions and the general public on analyzing, detecting and

reporting money laundering and terrorist financing transactions.

### iii. International relations

**a) Egmont Group :** The FIU obtained the membership of the Egmont Group, on 26 May 2009, in line with the application submitted in 2006. The Egmont Group, that consist of 116 members, is an association of FIUs established in 1995 to enhance mutual cooperation among member countries. Obtaining membership of the Egmont Group would enable the FIU Sri Lanka to develop vital relationships to facilitate exchange of financial intelligence with other FIUs and foster global partnerships in combating money laundering and terrorist financing. Since money laundering and terrorist financing are often globally organized, global cooperation of FIUs is a key strategy to deal with such activities.

**b) Asia Pacific Group on Money Laundering :** Sri Lanka, as a member country of Asia Pacific Group on Money Laundering (APG), attended its 12<sup>th</sup> annual meeting held in Australia in July 2009. Further, the FIU attended the 12<sup>th</sup> APG Annual Typologies Workshop in Cambodia in October 2009 to discuss various new methods, strategies and trends of worldwide money laundering and financing of terrorism.

**c) Assisting other Jurisdictions :** Information sharing with a number of jurisdictions including Denmark, India, Nigeria, Macedonia, Mauritius and several Egmont member countries were completed during the year. In addition, regular meetings with the foreign missions including Royal Canadian Mounted Police, the USA and Australia were conducted to share intelligence and to discuss matters relating to the progress of the FIUs.

## 11. FINANCIAL SYSTEM STABILITY

The Financial System Stability Department (FSSD) was established in 2007 to assist the CBSL in maintaining the financial system stability, which is one of the objectives of the CBSL. The main functions of the FSSD are the conduct of macro-prudential surveillance on the financial system to identify risks of a systemic nature and to coordinate remedial and preventive measures, compilation of the Annual Financial System Stability Review to educate the general public on the assessment of risks to the financial system and co-ordination of the work of the Financial System Stability Committee and the Financial System Stability Consultative Committee. At the end 2009, FSSD operated with a staff of nine, including five officers. A brief description of the main activities undertaken in 2009 is given below.

### 11.1 Macro-prudential Surveillance

Macro-prudential surveillance involved the compilation of macro-economic and financial system information

and analysis of such information to identify potential risks and material concerns to financial systems stability in the foreseeable future. Accordingly, FSSD conducted the surveillance on the basis of monthly and quarterly information collected from the relevant departments of the CBSL and other institutions outside the CBSL. This information base consisted of a large number of aggregate indicators on (i) financial soundness and risks of the banks and financial institutions such as credit, liquidity, market prices, profitability and capital (ii) foreign exchange and stock markets (iii) payments and settlements operations (iv) macro-economic performance. In addition to the standard assessment of such information, FSSD undertook two technical studies, i.e., stress tests and compilation of banking soundness index, to improve the analysis.

The stress tests on the banking sector were conducted to assess its resilience to extreme shocks with respect to credit risk, market risk and liquidity risk. Single factor stress tests were performed using sensitivity analysis on a quarterly basis. Integrated sensitivity analysis stress tests combining credit risk, interest rate risk and foreign exchange risk shocks, similar to scenario analysis, were also conducted. The Banking Soundness Index (BSI) was compiled from indicators relating to capital adequacy, profitability, asset quality, liquidity, asset-liability mismatches and foreign exchange exposure on a quarterly basis to monitor the aggregate soundness of the banking sector.

In 2009, the FSSD submitted 4 financial sector risk assessment reports to the Monetary Board. In addition FSSD prepared reports on proposals for consolidated supervision of diversified financial groups, the establishment of a regulatory authority for superannuation funds and the regulation of the unlisted corporate debt securities market.

### 11.2 Financial System Stability Review

The CBSL has published 5 annual Financial System Stability Reviews (FSSR) since 2004. In 2009, the FSSD prepared and published the FSSR 2008. The FSSR 2008 consisted of six chapters and contained six box articles. The FSSR 2008 included an overall assessment of financial system stability, potential vulnerabilities and risk mitigation measures, global and domestic macroeconomic developments, the performance of domestic financial markets, the banking sector performance and risks, developments and risks in other financial institutions (finance, leasing and insurance companies, primary dealers, superannuation funds, unit trusts and stockbrokers) and the functioning of the main payments and settlements systems and the regulatory framework. The FSSD also coordinated the preparation of the chapter on Financial Sector Developments and Stability in the CBSL Annual Report 2008 and the Recent Economic Developments 2009.

### 11.3 Coordination of the Committees on Financial System Stability

In 2009, the FSSD continued to function as the secretariat for the Financial System Stability Committee (FSSC) and the Financial System Stability Consultative Committee (FSSCC).

#### a) Financial System Stability Committee

The Financial System Stability Committee (FSSC) is chaired by the Deputy Governor in charge of financial system stability and had eleven members which included the heads of departments of Bank Supervision, Supervision of Non-Bank Financial Institutions, Payments and Settlements, Information Technology, Economic Research and Financial System Stability. The FSSC is the forum for co-ordination of efforts of a number of departments in the CBSL to promote the financial stability. The FSSC had nine meetings in 2009. The discussions at the FSSC mainly included the establishment of a mandatory deposit insurance scheme for deposit-taking institutions, guarantee scheme for the securitization of lease receivables of registered finance companies and specialized leasing companies, high transaction costs of the banking sector, temporary overdraft facilities provided by banks and the interest rates in the banking sector.

#### b) Financial System Stability Consultative Committee

The Financial System Stability Consultative Committee (FSSCC) which was appointed by the Monetary Board in 2008 and consisted of six members outside the CBSL who have expertise and experience in financial sector operations and issues. The FSSCC met 11 times in 2009 and discussed several proposals relating to registered finance companies (RFCs) such as the listing of RFCs on the Colombo Stock Exchange, regulatory limits on concentration risk of RFC lending, restrictions on deposit mobilization by RFCs that do not comply with regulatory capital and liquidity requirements, restricting the license to one RFC in a group, appointing a panel of auditors for RFCs, the consolidated supervision of RFCs and issue of a temporary government guarantee on deposit renewals of distressed RFCs. The FSSCC also made proposals on amendments to the Banking Act and the Finance Companies Act and establishing a Computer Emergency Response Team for the banking sector to prevent internet fraud.

## 12. GOVERNOR'S SECRETARIAT

In order to enable speedy attention and expertise to address issues, arising from the recent global and domestic financial market turbulence, the activities of the Governor's Office was expanded substantially in 2009. The Governor's Office which functioned as a part of the Secretariat Department was formed into a new department of the

CBSL, titled Governor's Secretariat Department (GSD) on 29 June 2009. The goal of the GSD is to provide extensive operational assistance as required by the Governor, in an efficient manner. In achieving this objective, the GSD was engaged in secretarial work, protocol services, follow up activities on work assigned by the Governor to the officers of the CBSL and facilitating effective good relations between the CBSL and other institutions as well as the public.

The GSD is entrusted with the responsibility of managing appointments of the Governor and attending to correspondence work. During the year under review, the Governor had a significant number of meetings with important visitors, including Governors of other Central Banks, Hon. Ministers, Hon. Members of Parliament, Ambassadors, Chief Executive Officers of banks and other financial institutions and media institutions, business leaders, and delegations from international financial institutions such as IMF, World Bank and other foreign delegations. All such appointments and correspondences relating to these meetings and follow-up work thereon were well communicated to the relevant parties assuring the smooth running of the Governor's schedules.

The GSD provided protocol services to the Governor, VIP visitors of the Governor, and VIP invitees to the CBSL. All arrangements for local and foreign travel of the Governor also were made by the GSD during the year. The Governor made field visits to several places of economic significance namely, Colombo Port, Galle Port and Hambantota Port, Kerawalapitiya Power Project and Jaffna for bank branch openings and to have meetings with business community and necessary travel arrangements together with protocol services for the Governor for such visits were made by the GSD. The Governor made a number of official visits abroad including to attend IMF-World Bank meetings, non-deal road shows, SAARC Finance Governor's symposium and many other international symposiums either as the chief guest or keynote speaker. While providing protocol services to the Governor for his foreign travels, the GSD also provided the necessary data and information and prepared presentations in order to ensure the success of such visits. Whenever the Governor was abroad, the GSD provided real time data on money and foreign exchange market operations and other timely important information. In addition, all official functions hosted by the Governor and Deputy Governors were arranged by the GSD.

The GSD provided necessary professional inputs which were requested by the Governor for meetings of committees of the CBSL chaired by him i.e., Corporate Management Committee meeting, Risk Management Committee meeting, Inter Regulatory Committee and meetings of bank CEOs etc. In addition, the GSD assisted in the preparation and presentation of the strategic plan 2010 – 2014 of the CBSL.

The Governor also attended meetings of the Finance Commission, National Economic Council, Cabinet Sub-Committee Meeting on Food Security and Cost of Living for which the GSD provided with necessary data and information. Further, during the year, the GSD had regular interactions with foreign investors and rating agencies and provided them with timely information and clarifications on the economy of Sri Lanka.

The GSD attended to the correspondence and communication, with regard to the IMF loan and the international sovereign bond issue with regard to both the above, a number of teleconferences were arranged. The Governor also made several presentations to foreign investors and Sri Lankan diaspora abroad for which necessary inputs and secretarial assistance were provided by the GSD.

The GSD closely followed up the instructions issued by the Governor to other departments and ensured that they were implemented. The GSD also assisted the public by responding to their queries, particularly with regard to matters, relating to the Employees' Provident Fund, finance companies, banking issues and other issues relevant to the bank.

### 13. HUMAN RESOURCES MANAGEMENT

As in previous years, in 2009 too the Human Resources Department (HRD) continued to assist the management to improve the quality of human capital of the CBSL through programmes to develop competencies and productivity of employees, initiating actions to recruit highly qualified and skilled staff and creating a conducive environment to maintain better employer-employee relations. Key functions carried out by HRD in this regard included recruitment, performance management, promotions, training and development, succession planning and job rotation in line with human resources needs identified by the Bank in its Strategic Plan.

#### 13.1 Human resources structure

As at the end of 2009, the total staff of the CBSL was 1,263 consisting of 530 staff class officers, 599 non staff class officers, 125 minor employees and 9 contractual employees. The average age of an employee of the CBSL was estimated to be around 45 years as of end 2009. As indicated in Table II – 9, nearly 83 per cent of employees in the staff class category had a first degree, postgraduate degree or a professional qualification. During 2009, nine employees were recruited, while 41 employees retired from the CBSL service. In 2009, five employees resigned from the CBSL service.

#### 13.2 Recruitment

As in 2008, HRD in 2009 also placed a high priority for new recruitments to fill the identified competencies gaps

in the CBSL. During the year, applications were called for the posts of Management Trainee, Banking Assistant and Minor Employee. HRD obtained the assistance of the Department of Examinations to conduct competitive examinations for the candidates applied for the posts of Management Trainee and Banking Assistant for the purpose of short listing them for the preliminary interviews. In respect of the post of Management Trainee, preliminary interviews were conducted based on the results of the competitive examination.

During the year, 7 legal officers, 1 court clerk and 1 technical officer were also recruited to fill the specific technical competency requirements of the CBSL under the lateral recruitment process.

Measures were also taken to absorb 59 Management Trainees, 118 Banking Assistants and 6 IT Technicians who were recruited in 2007 and 2008 as trainees, to the permanent cadre of the CBSL as probationary officers. In addition, 42 Security Officers and 5 English Steno-Typists who were serving in the CBSL on contract basis were absorbed to the permanent cadre. Measures were also taken to outsource the services of Medical Officer and Medical Nurse for the Medical Centre and Data Entry Operators for the EPF Department and the Statistics Department in 2009.

### 13.3 Performance Management System

The Performance Management System of the CBSL was designed in such a way that the performance of individual officers is evaluated in terms of their contribution to achieve vision and mission of the CBSL. At the beginning of the year, the performance evaluation process begins with the employees setting their own goals with appropriate weights for the goals, in consultation with the supervisors. Based on those goals, the employees complete the self-evaluation section of the performance evaluation form by giving a performance rating for each goal.

The performance evaluation discussion is held between the employee and the supervisor in order to arrive at a final performance rating. The overall ratings given by the supervisors are reviewed by the respective Head of Department. In addition, the employee submits the learning, training and career development plans along with the performance evaluation form to the supervisor for assessment.

Performance evaluation for the year 2008 for all employees was completed on target dates. Individual and departmental goal setting for the year 2009 was also carried out concurrently as per the time targets set out at the beginning of the year.

**Table II – 9**  
**Human Resources Structure as at 31.12.2009**

| Categories of Employees          | No. of Employees |            |             | Average Age | Educational/Professional qualifications                   |                              |   |  |              |                            |
|----------------------------------|------------------|------------|-------------|-------------|---|------------------------------|---|--|--------------|----------------------------|
|                                  | Male             | Female     | Total       |             | Post Graduate, First Degree & Professional Qualifications | Post Graduate & First Degree | Post Graduate & Professional Qualifications | First Degree & Professional Qualifications | First Degree | Professional Qualification |
| <b>(1) Staff Class</b>           |                  |            |             |             |   |                              |   |  |              |                            |
| (i) Grade IV and above           | 54               | 19         | 73          | 55          | 13  | 47                           | 02  | 04   | 07           | 0                          |
| (ii) Grade III                   | 63               | 18         | 81          | 51          | 07  | 37                           | 01  | 03   | 33           | 0                          |
| (iii) Grade II                   | 78               | 58         | 136         | 46          | 06  | 23                           | 01  | 16   | 63           | 06                         |
| (iv) Grade I                     | 94               | 146        | 240         | 40          | 02  | 19                           | 02  | 19   | 129          | 02                         |
| <b>(2) Non Staff Class</b>       |                  |            |             |             |   |                              |   |  |              |                            |
| (i) Grade V                      | 35               | 70         | 105         | 54          | 0   | 0                            | 0   | 0  | 29           | 01                         |
| (ii) Grade IV                    | 77               | 52         | 129         | 49          | 0   | 0                            | 0   | 0  | 11           | 01                         |
| (iii) Grade III                  | 78               | 18         | 96          | 48          | 0   | 0                            | 0   | 0  | 01           | 03                         |
| (iv) Grade II                    | 100              | 84         | 184         | 31          | 0   | 0                            | 0   | 0  | 01           | 01                         |
| (v) Grade I                      | 85               | 0          | 85          | 44          | 0   | 0                            | 0   | 0  | 0            | 0                          |
| <b>(3) Minor Employee Class</b>  |                  |            |             |             |   |                              |   |  |              |                            |
| (i) Grade I, II and III          | 118              | 07         | 125         | 38          | 0   | 0                            | 0   | 0  | 0            | 0                          |
| <b>(4) Contractual Employees</b> |                  |            |             |             |   |                              |   |  |              |                            |
| (i) All Categories               | 05               | 04         | 09          | 42          | 0   | 05                           | 0   | 0  | 0            | 0                          |
| <b>Total</b>                     | <b>787</b>       | <b>476</b> | <b>1263</b> | <b>45</b>   | <b>28</b>   | <b>131</b>                   | <b>06</b>                                   | <b>42</b>                                  | <b>274</b>   | <b>14</b>                  |

Source: Human Resources Development

### 13.4 Promotions

In 2009, HRD took measures to ensure that all staff members get their due promotions on time. The number of years in service, performance evaluation rating and the recommendations of the Heads of Department were used as the evaluation criteria for promotions. A total of 202 staff members were given their grade, class and position promotions in 2009. Of these, 23 Deputy Heads of Department were promoted to Staff Class Grade IV as Acting Additional Heads of Department. In addition, HRD also facilitated for promotion of 06 Heads of Department to Staff Class Special Grade as Assistant Governors and 04 Assistant Governors to the posts of Deputy Governor.

### 13.5 Training

HRD in 2009 continued to provide local and foreign training with the intension of filling identified competencies gaps of staff and developing a multi skilled labour force. The training opportunities provided in 2009 included foreign and local short-term programmes such as seminars, workshops, conferences and training programmes and opportunities for post-graduate studies. Nearly, 1,174 such training opportunities were provided during the year.

#### (a) Foreign training

The Bank provided opportunities for 141 officers to participate in a wide range of foreign training programmes, seminars and conferences conducted by reputed training institutions abroad in 2009. With a view to utilizing the knowledge gained through foreign training programmes effectively, the officers were requested to undertake special assignments to initiate new activities or improve existing activities aiming at enhancing quality of deliverables in the Bank. The Training Sub Committee appointed for this purpose conducted 17 pre and post training discussions with the officers who attended foreign training programmes in 2009.

#### (b) Post-graduate studies

The CBSL continued to provide facilities for its staff to acquire post-graduate qualifications both Master's and Ph.D. degrees from recognized universities in the UK, USA, Japan and Australia under its scholarship scheme aiming at enhancing the intellectual capacity of the CBSL. Accordingly, 4 officers commenced Master's Degree programmes in 2009. During the year, 2 officers resumed duties after successful completion of Master's Degree programme, while one officer resumed duties after completion of a Ph.D. programme.

#### (c) Local training

In 2009, the CBSL provided 1,029 opportunities for officers to participate in training programmes conducted by the Centre for Banking Studies (CBS) and other recognized

local training institutions. In providing local training, the priorities were given to enhance knowledge in the areas of information technology, communication, financial and capital markets, bank supervision, macro economic analysis, internal auditing, general management etc.

**Table II-10**  
**Short Term Foreign Training Opportunities - 2009**

| Field                            | No. of Participants |
|----------------------------------|---------------------|
| Economics and Economic Policies  | 30                  |
| Financial System and Regulations | 24                  |
| Risk Management                  | 11                  |
| Finance                          | 9                   |
| IT and Payment Systems           | 6                   |
| Public Debt Management           | 6                   |
| Central Banking                  | 19                  |
| Human Resources Management       | 20                  |
| Other                            | 16                  |
| <b>Total</b>                     | <b>141</b>          |

### 13.6 Job rotation

As part of job rotation programme, employees who served for more than five years in one department were transferred to some other departments, with a view of developing multi- skilled staff and enhancing overall productivity of the CBSL. The staff was rotated taking into account the competency level of the officers and competency requirements of the various departments. Under this programme, a total of 32 staff members were rotated in 2009.

### 13.7 Employer-employee relations

HRD facilitated the process of maintaining a close dialogue between the trade unions and the management during the year. The trade unions were given the opportunity to meet the management to discuss issues as and when such discussions were deemed necessary. Accordingly, during the year, 9 such discussions were held. This continuous dialogue facilitated for the management to resolve a number of issues relating to recruitment, promotions, training, welfare and general administration of the CBSL. In 2009, HRD successfully negotiated with trade unions and facilitated the signing of a collective agreement with all trade unions of the CBSL on the salary revision for the period 2009-2011.

#### Meetings Attended by the Governor

1. 44th SEACEN Governors' Conference and 28th Meeting of the SEACEN Board of Governors in Malaysia, in February.
2. South Asia Forum on the Impact of Global Economic and Financial Crisis in the Philippines, in March.

3. Official visit to IMF Headquarters in Washington D.C., USA, in March.
4. IMF-World Bank Spring Meetings in Washington D.C., USA and Official visits to the UK, Italy and Libya in April - May.
5. Non-deal Roadshow in Singapore & Hong Kong and Official Meetings in London, UK in July.
6. Official visits to Mumbai, India in July - August.
7. Jesus College, Cambridge, UK to deliver the Keynote address at the 27th International Symposium on Economic Crime in September.
8. IMF-World Bank Annual Meetings in Istanbul, Turkey in October.
9. SAARCFINANCE Governors' Symposium on Food Security in Bangladesh and Official Meetings in Bangkok, Thailand in October.
10. Official visit to Australia to attend meeting arranged by Sri Lanka High Commission in Melbourne, in October - November.
11. Silver Jubilee Celebrations of the India-ASEAN-Sri Lanka Chamber of Commerce & Industry in Chennai in November.
12. Investor Forum in Singapore in November.

#### PROMOTIONS/APPOINTMENTS

1. Dr. P B Jayasundara, Secretary to the Ministry of Finance and Planning became the official member of the Monetary Board, being the officer holding office of Secretary to the Ministry of Finance, with effect from 29 September 2009.
2. The following promotions and appointments were made effective during the year 2009.
  - I. Mrs. M. A. R. C. Cooray was appointed as Deputy Governor with effect from 13 March 2009.
  - II. Mr. K. G. D. D. Dheerasinghe was appointed as Deputy Governor with effect from 23 May 2009.
  - III. Dr. P. W. R. B. A. U. Herat was appointed as Deputy Governor with effect from 27 May 2009.
  - IV. Dr. D. S. Wijesinghe was appointed as Deputy Governor with effect from 07 July 2009.
  - V. Mr. W. M. Karunaratne was promoted to Staff Class Special Grade and appointed as Assistant Governor with effect from 10 August 2009.
  - VI. Mrs. P. Liyanage was promoted to Staff Class Special Grade and appointed as Assistant Governor with effect from 10 August 2009.
  - VII. Mrs. J. P. Mampitiya was promoted to Staff Class Special Grade and appointed as Assistant Governor with effect from 10 August 2009.
  - VIII. Mrs. C. K. Nanayakkara was promoted to Staff Class Special Grade and appointed as Assistant Governor with effect from 10 August 2009.
  - IX. Mr. B. D. W. A. Silva was promoted to Staff Class Special Grade and appointed as Assistant Governor with effect from 10 August 2009.
  - X. Dr. P. N. Weerasinghe was promoted to Staff Class Special Grade and appointed as Assistant Governor with effect from 10 August 2009.
  - XI. Mr. S. M. A. Siriwardane was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Regional Development Department with effect from 01 September 2009.
  - XII. Miss. A. S. De Alwis was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Statistics Department with effect from 01 September 2009.
  - XIII. Mrs. R. B. Weerasinghe was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Payments and Settlements Department with effect from 01 September 2009.
  - XIV. Mrs. C. M. D. N. K. Seneviratne was promoted to Staff Class Grade IV and appointed as Acting Additional Superintendent of the Employees' Provident Fund Department with effect from 01 September 2009.
  - XV. Mr. T. M. Z. Mutaliph was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Governor's Secretariat Department with effect from 01 September 2009.
  - XVI. Mr. H. Amaratunga was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Provincial Offices Monitoring Department with effect from 01 September 2009.
  - XVII. Mrs. Prema Wijesinghe was promoted to Staff Class Grade IV and appointed as Acting Additional Secretary of the Central Bank of Sri Lanka with effect from 01 September 2009.
  - XVIII. Mrs. K. Dassanayake was promoted to Staff Class Grade IV and appointed as Acting Director



- of the Governor's Secretariat Department with effect from 01 September 2009.
- XIX. Mr. C. B. Pathberiya was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Information Technology Department with effect from 01 September 2009.
- XX. Mr. D. K. Wijesuriya was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Financial Intelligence Unit with effect from 01 September 2009.
- XXI. Mr. A. M. N. Gunawardana was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Management Audit Department with effect from 01 September 2009.
- XXII. Mr. K. L. L. Fernando was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Premises Department with effect from 01 September 2009.
- XXIII. Mr. W. R. A. Dharmaratne was promoted to Staff Class Grade IV and appointed as Acting Additional Superintendent of Currency with effect from 01 September 2009.
- XXIV. Mr. H. B. D. Karunaratne was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Department of Supervision of Non-Bank Financial Institutions with effect from 01 September 2009.
- XXV. Mrs. N. H. E. R. Siriwardane was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Department of Supervision of Non-Bank Financial Institutions with effect from 01 September 2009.
- XXVI. Mr. S. R. Attygalle who was released to the Ministry of Finance and Planning was promoted to Staff Class Grade IV and appointed as Acting Additional Head of Department with effect from 01 September 2009.
- XXVII. Mrs. H. P. T. Wijesuriya was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Economic Research Department with effect from 01 September 2009.
- XXVIII. Mr. B. L. J. S. Balasuriya was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Security Services Department with effect from 01 September 2009.
- XXIX. Mr. K. M. M. Siriwardena was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Economic Research Department with effect from 01 September 2009.
- XXX. Mr. N. W. G. R. D. Nanayakkara was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Bank Supervision Department with effect from 01 September 2009.
- XXXI. Mr. A. M. R. K. Attanayake was promoted to Staff Class Grade IV and appointed as Acting Additional Controller of Exchange with effect from 01 September 2009.
- XXXII. Mr. T. D. H. Karunaratne was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Centre for Banking Studies with effect from 01 September 2009.
- XXXIII. Mr. M. S. K. Dharmawardena was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Regional Development Department with effect from 01 September 2009.
3. Mr. E. A. Hettiarachchi, Acting Controller of Exchange, was appointed as Controller of Exchange with effect from 21 January 2009. Subsequently, he was appointed as Director of the Regional Development Department with effect from 11 August 2009.
4. Mr. C. P. A. Karunatilake, Acting Superintendent of Currency, was appointed as Superintendent of Currency with effect from 26 March 2009.
5. Mr. F. C. S. Mendis, Acting Additional Director of the Management Audit Department, was appointed as Acting Director of the Provincial Offices Monitoring Department with effect from 01 April 2009 and subsequently as Director of the Provincial Offices Monitoring Department with effect from 01 October 2009.
6. Mr. M. J. S. Abeysinghe, Additional Director of the Statistics Department, was appointed as Acting Director of the Statistics Department with effect from 01 June 2009 and subsequently as Acting Superintendent of the Employees' Provident Fund Department with effect from 01 September 2009 and as Superintendent of the same department with effect from 01 December 2009.
7. Mr. P. H. O. Chandrawansa, Acting Additional Director of the Department of Supervision of Non-Bank Financial Institutions, was appointed as Acting Additional Controller of Exchange with effect from 01 June 2009 and subsequently as Acting Controller of Exchange with effect from 11 August 2009.

8. Mr. H. M. Ekanayake, Acting Additional Director of the Security Services Department, was appointed as Acting Additional Director of the Department of Supervision of Non-Bank Financial Institutions with effect from 09 June 2009 and subsequently as Additional Director of the same department with effect from 15 July 2009.
9. Mrs. T. M. J. Y. P. Fernando, Additional Director of the Bank Supervision Department, was appointed as Acting Director of the Bank Supervision Department with effect from 11 August 2009.
10. Mr. R. A. A. Jayalath, Additional Director of the International Operations Department, was appointed as Acting Director of the Domestic Operations Department with effect from 11 August 2009.
11. Mr. K. D. Ranasinghe, Additional Director of the Economic Research Department, was appointed as Acting Director of the Economic Research Department with effect from 11 August 2009.
12. Mr. U. H. E. Silva, Additional Superintendent of the Employees' Provident Fund Department, was appointed as Additional Director of the Premises Department with effect from 11 August 2009.
13. Mr. K. B. Dissakaruna, Additional Director of the Payments and Settlements Department, was appointed as Acting Director of the Payments and Settlements Department with effect from 11 August 2009.
14. Mr. A. A. M. Thassim, Additional Director of the Bank Supervision Department was appointed as Additional Director of the Payments and Settlements Department with effect from 11 August 2009 and subsequently as Additional Director of the International Operations Department with effect from 01 September 2009.
15. Mr. D. M. Rupasinghe, Additional Director of the Financial Intelligence Unit was appointed as Acting Director of the Financial Intelligence Unit with effect from 11 August 2009.
16. Mr. H. A. Karunaratna, Director of the Financial Intelligence Unit was appointed as Director of the International Operations Department with effect from 11 August 2009.
17. Mr. A. Kamalasiri, Director of the Domestic Operations Department was appointed as Secretary of the Central Bank of Sri Lanka with effect from 11 August 2009.
18. Mr. D. Wasantha, Superintendent of the Employees' Provident Fund Department was appointed as

Director of the Statistics Department with effect from 01 September 2009.

#### RETIREMENTS/RESIGNATIONS

1. Mr. S. Abeysinghe, ceased to function as a member of the Monetary Board with effect from 28 September 2009 upon his appointment as the Secretary to the Office of the Cabinet of Ministers.
2. Mr. Tilak De Zoysa, ceased to function as a member of the Monetary Board with effect from 01 July 2009 upon expiration of his term of office as an appointed member of the Monetary Board.
3. Mrs. M. A. R. C. Cooray, Deputy Governor, retired from the Bank service with effect from 23 May 2009.
4. Dr. (Mrs) Ranee Jayamaha, Deputy Governor, retired from the Bank service with effect from 27 May 2009.
5. Mr. W. A. Wijewardena, Deputy Governor, retired from the Bank service with effect from 07 July 2009.
6. Mr. S. H. A. M. Abeyratne, Assistant Governor, retired from the Bank service with effect from 15 January 2009.
7. Mr. G. D. Gunarathna, Additional Superintendent of Currency, retired from the Bank service with effect from 01 August 2009.
8. Mr. R. J. Perera, Additional Director of Premises Department, retired from the Bank service with effect from 11 August 2009.
9. Mr. S. Somapala, Director of Statistics Department, retired from the Bank service with effect from 01 September 2009.
10. Dr. H. N. Thenuwara, Assistant Governor, resigned from the Bank service with effect from 21 October 2009.
11. Dr. P. W. R. B. A. U. Herat, Deputy Governor, passed away on 23 October 2009.

#### OFFICERS ON RELEASE/LEAVE

1. Mr. K. G. D. D. Dheerasinghe, Deputy Governor, to the International Monetary Fund as Alternate Executive Director.
2. Mr. S. R. Attygalle, Staff Class Grade IV officer, to the Ministry of Finance and Planning.
3. Mr. B. Lokuranamuka, Staff Class Grade III officer, to the Ministry of Finance and Planning.

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| <ol style="list-style-type: none"> <li>4. Mr. H. P. M. Wasantha Kumara, Staff Class Grade II officer, to the Ministry of Finance and Planning.</li> <li>5. Mr. M. Mahinda Saliya, Staff Class Grade II officer, to the Ministry of Finance and Planning.</li> <li>6. Mr. K. Munasinghe, Staff Class Grade I officer, to the Ministry of Finance and Planning.</li> <li>7. Mrs. H. P. A. Priyashanthi, Staff Class Grade I officer, to the Ministry of Finance and Planning.</li> <li>8. Mr. J. A. A. Priyantha, Staff Class Grade I officer (Probationary), to the Presidential Secretariat.</li> <li>9. Mrs. D. K. Uyangodage, Staff Class Grade I officer, to the International Monetary Fund.</li> <li>10. Mrs. H. M. N. S. Gunawardena, Legal officer (Contract), to the Ministry of Finance and Planning.</li> <li>11. Mr. S. N. W. Karunadasa, Driver (Minor Employee Grade III), to the Ministry of Finance and Planning.</li> <li>12. Mrs. R. Dheerasinghe, Staff Class Grade IV officer, on No-pay Leave.</li> </ol> | <ul style="list-style-type: none"> <li>• Automation of Asian Clearing Union (ACU) related SWIFT messages generation process and SWIFT payment gateway to enable straight through processing of LankaSettle/LankaSecure transactions</li> <li>• Expansion of the central database application to collect regulatory information reported by specialized leasing companies</li> <li>• Modifications to ACU system to support multi currency transactions</li> <li>• Installation of the upgraded Lanka Settle/Lanka Secure application software (CAS/CSS 3.5) and related interfaces to incorporate enhanced business functionalities</li> <li>• Provisioning of technical assistance to facilitate investigations of problem financial institutions and developing of software applications to gather information to handle such investigations to ensure financial system stability</li> <li>• Implementation of a comprehensive financial intelligence software solution including a module for web-based submission of statutory reports to the CBSL by the participating financial institutions</li> <li>• Extended the re-engineering project for Employees' Provident Fund (EPF) internal operations by simplifying the internal operations and accounting system</li> <li>• Provided extended information services to EPF stakeholders using service oriented architecture</li> <li>• Several other software applications to automate the internal functions of the CBSL</li> </ul> |
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#### 14. INFORMATION TECHNOLOGY

The Information Technology Department (ITD) continued its role as a strategic business enabler, promoting greater efficiency in the delivery of service through the implementation of appropriate technological solutions. The functions carried out by the ITD during the year can be categorized into three major areas, namely, (a) Development and maintenance of secure business applications; (b) IT infrastructure development and (c) Provisioning of value added IT services aligning IT strategy with the overall business strategy of the CBSL.

##### 14.1 Development and Maintenance of Secure Business Applications

The ITD, while providing continued support for maintenance of existing applications, responded to all urgent and planned software requirements of the CBSL during the year. The following major applications were implemented representing all clusters of the CBSL.

- Facilitated Term Repo and dollar-SWAP auctions through OMO window as a tool for executing monetary policy
- Redesigned Liquidity Monitoring System and USD-SLR Transactions Monitoring System as secure web applications
- Facilitated the submission of outward clearing cheques in CD mode based on a decision made by the National Payments Council

The ITD was able to maintain the average operational availability of the systematically important payment system at 99.9 per cent, far above the expected norm. Availability of all other systems, including the EPF system, was maintained at almost 100 per cent during the year.

##### 14.2 ICT Infrastructure Developments

The ITD continued administering of the wide area network (CBSLNET) of the CBSL to provide required services to the participating financial institutions. To support internet browsing for research and development work and to enhance the performance of web-based applications deployed by the CBSL, the internet leased line capacity was expanded to 6Mbps which has resulted in improved services and response time. The intrusion prevention system, installed at the network gateway, was updated on several occasions during the year to further strengthen the

detection and prevention of hacking attempts to IT systems of the CBSL from external parties.

E-mail communication system was further extended to facilitate senior officers of the CBSL, officers of provincial offices and IT technical staff to access the corporate e-mail system, remotely. This has enabled the increase of system availability of all IT applications operated by the ITD.

### 14.3 Value Added IT Services

The ITD worked towards fulfilling the vision of the CBSL, 'achieving prosperity of the country', by providing enhanced value added IT services to related outside organizations. Accordingly, advisory services and technical expertise were provided to the local SWIFT user group, Common Payment Switch (SLCPS) project which is a project of national interest, establishment of the certification authority for the banking and financial sector (LankaSIGN), and procurement of a common Anti-Money Laundering (AML) software for the financial sector. Two Business Continuity Plan (BCP) drills were conducted from the remotely located Disaster Recovery Site (DRS) with the participation of LankaSettle participants, foreign counterparts and other internal departments of the CBSL.

With the aim of enhancing ICT competencies, the ITD continued the practice of releasing officers as resource persons to the Centre for Banking Studies to share their expertise and skills with other financial sector staff. Further, the ITD was engaged in conducting internal training/awareness sessions for departmental liaison officers.

With a view to providing uninterrupted IT support services to the staff, IT help desk facilities were provided from 0700 hours to 1830 hours during all working days. As a means of improving IT productivity in the CBSL through enhanced security, a security booklet and a business continuity leaflet were prepared and distributed among the relevant officers. Information security awareness sessions were conducted at each department to minimize information security breaches.

A common self-access/learning area called "Pariganaka Piyasa" was established with modern computers, latest versions of software applications/packages and access to internet facilities, encouraging all levels of staff to upgrade their ICT skills.

## 15. INTERNATIONAL OPERATIONS

The responsibilities relating to the management of the official international reserves of Sri Lanka is entrusted to the International Operations Department (IOD) by the Monetary Board for the purpose of maintaining the external stability of the Sri Lanka rupee and to facilitate the country's international transactions. Accordingly, as the circumstances demand and justify, the IOD participates in the domestic foreign exchange market and monitors the

market with the view to curbing the excess volatility in the exchange rate in order to ensure smooth operation of the market.

### 15.1 International reserve management

During the year 2009, the CBSL was able to manage its international reserves prudently while overcoming the challenges in curbing the excess volatility in the exchange rate and achieve a relatively high rate of return from the investment of international reserves. The end of the conflict, which existed for nearly 30 years in the country, and the gradual easing of the worldwide financial turbulence contributed towards enhancing the foreign currency inflows with the return of foreign investors to the local government securities market. The receipts from the IMF Stand-By Arrangement facility and the international sovereign bond issue also helped to improve the reserves, which rose to its highest level in the Sri Lankan history of over US dollars 5 billion by end 2009. Globally, it was another challenging year for reserve management activities as the impact of the global financial turmoil spilled over to the year 2009 and the recovery of the global economy was slower than anticipated. Under these circumstances, the IOD had to perform an arduous task in managing the international reserves, particularly during the first four months of the year 2009, as it was a difficult period with the international reserves being depleted to low levels due to significant outflows arising from large import bills and withdrawal of investments by foreigners in the stock market and in Treasury bills and bonds.

During the year under review, investments of the international reserves were undertaken in accordance with the foreign exchange reserve management guidelines approved by the Monetary Board, under the supervision of the Foreign Reserve Management Committee (FRMC). The international reserves, which consisted of currencies such as US dollars, euros, sterling pounds, Australian dollars and gold, was invested mainly in two asset classes namely, fixed income securities and money market instruments. The CBSL's fixed income securities portfolio consisted of highly rated sovereign government securities, government guaranteed securities, and securities of government agencies and supranational institutions. The transactions on investments on both fixed income securities and money market were performed only through highly rated and approved counter parties within the limits structure approved by the management, paying due consideration to safety, liquidity and return on such assets. Liquidity requirements of the CBSL, debt service payments, risk management parameters, income generating abilities and specific directions of the Monetary Board were the key elements considered in determining the asset and currency composition of the reserve portfolio.

The CBSL's overall reserve management operations have generated a net foreign income of US dollars 100.9 million

(Rs.11,523 million) during the year 2009, exceeding the budgeted income of US dollars 42.3 million. In the midst of relatively low interest rates that prevailed in the major economies, capital gains on fixed income securities contributed the most to the increased income.

### 15.2 Risk management

The risks associated with the international reserves and its investments have been monitored continuously by the Middle Office of the IOD. The international reserves and their investments are exposed to various categories of risks. Among these risk categories, exchange rate risk, interest rate risk, credit risk, liquidity risk and operational risks are considered as major components. Exchange rate risk or the risk of capital loss as a consequence of fluctuations in exchange rates has been managed mainly through diversification of investment currencies. Interest rate risk or the exposure of the CBSL's reserve portfolio to movements in interest rates has been managed through appropriate adjustments to the duration of the portfolio. Counterparty Credit Risk Management System (CCRMS), which is a system that facilitates a comprehensive evaluation of the counterparties based on financial indicators, ratings and products, is used by the IOD to manage the credit risk. The liquidity risk, which is the risk of incurring capital losses in the event of forced liquidation, is managed by establishing liquidity requirements and maintaining a sufficient proportion of assets in highly liquid form. The operational risk resulting from human error, flawed systems and inadequate procedures and controls were managed through measures such as strengthening of the verification process, improvements to the trading system and updating of the investment guidelines.

Appropriate precautionary measures continued during the early part of the year 2009 such as diverting money market investments to central banks and timely eliminating of exposure to foreign commercial banks, limiting trading activities during highly volatile market conditions, strengthening the monitoring and evaluation of credit and liquidity risk were adopted by the IOD to mitigate the adverse impact caused through the global financial crisis.

The elevated credit risk exposure as a result of the global financial crisis which prevailed during 2008 decreased during the latter part of the year 2009 as most of the major central banks provided unprecedented support to the financial institutions to ensure smooth functioning of the financial sector. This paved the way for CBSL to recommence placing money market investments in foreign commercial banks during the latter part of the year. Accordingly, money market investments were placed in highly rated foreign commercial banks with the approval of the Monetary Board in October 2009.

The CBSL also established a Nostro account and a securities custody/clearing account at the Bank of Japan, to facilitate Japanese yen investments. This would enable the CBSL to reduce the credit risk exposure related to Japanese yen investments to a considerable extent in the future.

### 15.3 Domestic foreign exchange market developments

IOD continued to participate in the activities of the domestic foreign exchange market and also conducted close monitoring of the market, mainly the foreign exchange transactions and overnight net foreign exchange positions of commercial banks, during the year 2009, in order to promote the smooth functioning of the domestic foreign exchange market and to ensure an orderly adjustment of the exchange rate of the domestic currency.

**Table II-11**  
**Inter-Bank Foreign Exchange Transactions Volume – 2009**  
(US\$ mn)

| Month        | Spot            | Tom             | Cash            | Forward         | Total            |
|--------------|-----------------|-----------------|-----------------|-----------------|------------------|
| January      | 263.50          | 186.30          | 111.85          | 313.16          | 874.81           |
| February     | 260.00          | 191.96          | 121.25          | 324.46          | 897.67           |
| March        | 276.51          | 210.58          | 190.55          | 495.59          | 1,173.23         |
| April        | 234.45          | 148.00          | 98.16           | 341.33          | 821.94           |
| May          | 424.42          | 67.32           | 69.85           | 355.15          | 916.74           |
| June         | 300.60          | 59.05           | 70.62           | 387.62          | 817.89           |
| July         | 266.05          | 126.45          | 99.25           | 451.90          | 943.65           |
| August       | 316.35          | 94.50           | 100.52          | 413.76          | 925.13           |
| September    | 222.75          | 128.35          | 82.90           | 283.05          | 717.05           |
| October      | 247.25          | 132.40          | 61.15           | 451.03          | 891.83           |
| November     | 375.20          | 145.45          | 68.61           | 516.84          | 1,106.10         |
| December     | 349.07          | 114.30          | 119.60          | 289.83          | 872.80           |
| <b>Total</b> | <b>3,536.15</b> | <b>1,604.66</b> | <b>1,194.31</b> | <b>4,623.72</b> | <b>10,958.84</b> |

Source: International Operations Department, Central Bank of Sri Lanka

The pressure on the exchange rate increased in the first quarter of the year 2009 mainly due to large import bills which resulted in the depreciation of the Sri Lanka rupee. During the first 3 months of 2009, CBSL played an active role in the foreign exchange market to mitigate the volatility of the exchange rate. However, the rupee continued to depreciate against major currencies during the months of April and early May 2009 due to the significant outflows. The end of the conflict in mid-May, approval of the IMF Stand-By Arrangement facility, increased foreign investments in government securities and the proceeds of the international sovereign bond issue contributed towards the appreciation of the Sri Lanka rupee since the latter part of the second quarter 2009. The total amount of dollars injected to the domestic foreign exchange market by the CBSL was US dollars 830 million and the amount absorbed was US dollars 3,122 million resulting in a net purchase of US dollars 2,291 million during the year 2009.

**Table II-12**  
**Purchases and Sales of Foreign Exchange by the**  
**Central Bank – 2009** (US\$ mn)

| Month        | Purchases       | Sales         | Net             |
|--------------|-----------------|---------------|-----------------|
| January      | 20.50           | 272.20        | (251.70)        |
| February     | 10.50           | 250.48        | (239.98)        |
| March        | 73.50           | 127.5         | (54.00)         |
| April        | 37.25           | -             | 37.25           |
| May          | 123.00          | -             | 123.00          |
| June         | 290.00          | -             | 290.00          |
| July         | 289.10          | -             | 289.10          |
| August       | 1,130.75        | -             | 1,130.75        |
| September    | 437.15          | -             | 437.15          |
| October      | 363.95          | 118.45        | 245.50          |
| November     | 286.90          | 28.10         | 258.80          |
| December     | 59.40           | 33.35         | 26.05           |
| <b>Total</b> | <b>3,122.00</b> | <b>830.08</b> | <b>2,291.92</b> |

Source: International Operations Department, Central Bank of Sri Lanka

The exchange rate of Sri Lanka rupee depreciated by 1.07 per cent against the US dollar in 2009. It moved from 113.1398 per US dollar as at end 2008 to 114.3844 per US dollar as at end 2009. The volume of inter-bank foreign exchange transactions which amounted to US dollars 14,131.77 million in 2008 decreased to US dollars 10,958.84 million in 2009 recording a significant decline of 22.45 per cent reflecting mainly the decline in international trade related payments. The net foreign exchange exposure positions of commercial banks were increased during the year in order to enhance the market activities and to facilitate the smooth operations of the domestic foreign exchange market. The process of providing information on exchange rates of Sri Lanka rupee against other currencies to government departments, corporations, local and foreign agencies and other parties continued during 2009 as in the previous years.

## 16. MANAGEMENT AUDIT

The Management Audit Department (MD) exists to assist CBSL in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the CBSL risk management, internal control, and governance processes. In line with the above, MD continued to provide independent objective assurances and consultancy services to the management in improving internal controls of the CBSL during 2009 with a view of adding value to the operations of the CBSL. Accordingly, the MD evaluated the existing systems and controls and made suggestions and recommendations for improvements of several systems and controls.

The MD attended to several programmes to enhance the quality and the effectiveness of its activities during 2009. One such programmes was the Internal Audit Quality Assessment Review (QAR), conducted by the Institute of Internal Auditors, Malaysia in collaboration with Columbus

Advisory Sdn. Bhd., based on the International Internal Auditing Standards. Also, MD initiated several actions to move towards adopting risk-based audit methodology for conducting audits. Further, the Annual Audit Plan (AAP) 2010 was prepared partially based on the risk-based audit methodology.

While focusing on the improvements to audit functions as explained above, the MD carried out its internal audit function to facilitate the CBSL to achieve the targets specified in CBSL's Strategic Plan 2009 by providing value added assurances and consultancy services on operations and processes of other departments and systems of controls through conducting audit assignments as set out in the approved AAP 2009. In addition to the audit assignments set out in the AAP 2009, the Department performed a comprehensive process study to ensure the accuracy of the net international reserves (NIR) and reserve money (RM) data reporting methodology of the ERD. Such an assignment has enhanced the validity of the NIR and RM data monthly reported to the International Monetary Fund (IMF). Further, MD was engaged in verification of the data reported to IMF on three test dates; June, July and September, 2009.

The MD initiated several measures during the year 2009 to develop its capabilities and competencies in the information systems (IS) audit activities. The procurement of audit command language (ACL) software, obtaining access to major information databases in computerized systems through ACL and training of selected staff in operating the ACL software to retrieve and analyse data were some of the major initiatives. Further, the MD was able to conclude several IS audit assignments during the year 2009 including the audit of welfare loan granting system (WelGSys), review of the implementation of the information security policy (ISP), review of the effectiveness of implementation of the business continuity plan and audit of regional development loan scheme. The MD was able to add value to the above systems/processes by making recommendations for improvements especially on system security issues and risk mitigation.

The MD was able to complete almost all the audit assignments set out in the approved AAP 2009 and attended in all pre-audit requirements of Secretariat Department and Welfare Department relating to PF refunds, pension payments and granting housing loans for the CBSL staff. The major audit assignments conducted during 2009 include the review of the CBSL cheque clearing process at Domestic Operations Department (DOD), the review of the Open Market Operations (OMO) conducted by DOD to achieve reserve money targets, review on the financial statement closure process, review of investment process of the Regional Development Department (RDD), review of the effectiveness and the conformity to the CBSL procurement guidelines in the construction project

of Regional Office at Matala, review of the process of foreign loan repayment, process review on the activities of OMO front office and Domestic Banking Division at DOD, review of the limit utilization in foreign reserves management, examination of gold investment and trading activities, review of risk management activities carried out by International Operations Department and audit of Tea Development Project Revolving Fund at RDD. The observations and recommendations of the audits were reported to relevant departments and also to the Governor, Audit Committee and the Monetary Board regularly. The follow up audits on each individual audit assignment were also conducted to ensure that audit recommendations are implemented by the respective Departments effectively and on a timely manner.

The MD continued to upgrade the bank-wide risk management framework until June 2009, and thereafter the individual departments were empowered to implement the risk management function in line with the established guidelines in the CBSL risk management framework. Further, the MD also contributed to the risk management function of the CBSL by reviewing the systems in place to achieve the objectives of several key business processes within the defined risk tolerance levels by selecting four departments; DOD, Currency, Finance and Welfare.

In 2009, the Monetary Board approval was obtained to embark on a gradual transition from present compliance audit practices to risk based internal audit practices. The transition would facilitate the MD to enhance value of its limited resources by deploying them in the audit of most vulnerable operations of the CBSL selected based on a systematic risk rating approach. The required actions are to be taken from the beginning of the year 2010 and will be continued till 2014. The MD continued to upgrade the skill/capacity level of its staff during 2009. Internal workshops and in-house training programmes were conducted to improve the knowledge of the staff on risk based auditing, internal auditing standards (IAS) and other audit tools and techniques. All officers of the MD attended a programme at the Centre for Banking Studies on new tools and techniques of internal auditing conducted by a qualified and experienced outside internal auditor while a few officers were trained overseas on internal auditing, including information systems audit.

## 17. PAYMENTS AND SETTLEMENTS

In terms of the Payment and Settlement Systems Act No. 28 of 2005, the CBSL is entrusted with a legislative mandate to implement the national payment system policy and oversee the payments and settlements systems in the country to ensure safety, efficiency, competitiveness and stability of the financial system. Being the operator, regulator, supervisor, facilitator and the user of the payments and settlements systems in the country, the CBSL undertakes

the mission of providing safe, sound and efficient payments systems through the Payments and Settlements Department (PSD). In fulfilling these objectives, the PSD operates the Real Time Gross Settlement (RTGS) system for the high value interbank payments in the country and back office functions for foreign exchange reserve management and open market transactions. In addition, internal and external funds and securities transfers are facilitated through the management of SWIFT transactions. At the same time, in order to ensure the smooth functioning of the payments and settlements systems and to mitigate the plausible risk on systems, the PSD carries out the oversight activities of payments and settlements systems. As in the past, in order to strengthen the co-operation with the countries in the region, the PSD facilitated the timely settlement of the ACU transactions during the year, hosted the ACU Board of Directors meeting in June 2009 and functioned as the secretariat of the SAARC Payments Initiative.

### 17.1 Operating the Real Time Gross Settlement (RTGS) System

The PSD carried out the settlement of time critical inter-bank payments of the financial system and third party payments of participants on real time gross basis and provided liaison services, including help desk services to participants throughout the operating hours of the system during the year 2009. The total volume of transactions settled through the RTGS system during the year was 232,567 amounting to Rs. 33,155 billion indicating a 32 per cent increase in value terms over the previous year. The RTGS recorded its highest volume of 1,465 transactions and amount of Rs. 295 billion during the year 2009. The average volume and value of transactions settled through the system per day was 965 and Rs. 138 billion, respectively. As the facilitator of the payments systems, in order to ensure smooth operation of the RTGS system, the CBSL provided around Rs. 11.3 billion per day as temporary liquidity to the participants through the Intraday Liquidity Facility (ILF).

As at end 2009, participants in the RTGS system consisted of CBSL, 22 LCBs, 7 non-bank Primary Dealers, Employees' Provident Fund (EPF) and the Central Depository System (CDS) of the Colombo Stock Exchange. Sampath Surakum Ltd, one of the Primary Dealers, was amalgamated with Sampath Bank Ltd. and therefore, the total number of LankaSettle participants was 32 as at end 2009. The system availability of the RTGS system was 99.9 per cent during the year 2009. In order to ensure the readiness of the system during contingency events, two live operation sessions were conducted successfully at the secondary site during the year, and each participating institution was encouraged to upgrade business continuity planning in their respective institutions, in line with the directions issued by the CBSL. System upgrading activities were also continued to facilitate the requests

made by participants to reduce the human involvement at different levels and to ensure full compliance with the 10 core principles put forward by BIS for systemically important payment system, such as the RTGS system. These enhancements were undertaken on a cost sharing basis where all participants agreeing to bear an equal share of the cost. Considering the enhanced facilities provided by the CBSL to LankaSettle participants through the system and as an operational cost recovery mechanism, the fee charged from participants was increased to Rs. 400 per transaction with effect from 1st February 2009, from Rs. 240 per transaction which had been charged since the inception of the LankaSettle system in 2003.

### 17.2 Settlement of deals under foreign exchange reserve management

The PSD continued foreign exchange, gold and foreign securities operations during the year by providing smooth and reliable settlement process through the Treasury Dealing Room Management System (TDRMS). As in the past, the PSD continued to handle all back office transactions without any defaulty or penalty charges and with 100 per cent accuracy. The PSD executed 7,185 settlement instructions amounting to US dollars 50.87 billion during the year.

With the unprecedented growth of the foreign reserves, transactions on forex, gold and foreign securities carried out by the International Operations Department (IOD) increased significantly in the latter part of 2009. To align with this increase, the PSD took steps to enhance its human and operational capacity. Further, the PSD was involved in upgrading the existing TDRMS to achieve state through processing (STP) in line with the Euroclear system enhancements and IOD modernization arrangements.

### 17.3 Settlement of transactions under open market operations (OMO)

The PSD is responsible for the back office operations of the Domestic Operations Department (DOD). As such the PSD effected 2,931 repo transactions amounting to Rs. 1,788 billion, 2,793 Reverse Repo transactions amounting to Rs. 1,021.8 billion, 169 outright sale transactions amounting to Rs. 69.6 billion, and 1,601 CBSL securities transactions amounting to Rs. 1,779.5 billion during the year. There were no outright purchases of securities by the CBSL during the year.

The PSD provided ILF for the participants through the LankaSettle system and monitored the settlement of ILF. During the year, 8,207 ILF transactions amounting to Rs.2,732.8 billion were provided and settled in the RTGS system.

### 17.4 SWIFT Communications

During 2009, the PSD handled all SWIFT related activities of the CBSL. The PSD was involved in the upgrading of

the SWIFT infrastructure whereby the SWIFT Net Link (SNL) and the alliance access versions were enhanced.

The total number of SWIFT messages sent and received in 2009 were 1,217,136 and 761,021 respectively. Out of the total messages received in 2009, 167,059 were for the CBSL transactions while the balance was for RTGS and SSSS transactions.

### 17.5 Transactions under the Asian Clearing Union (ACU)

The total value of transactions effected through the ACU mechanism by Sri Lanka decreased substantially by 47.5 per cent to Rs. 191 billion in 2009 from Rs. 363 billion in 2008. This decline was due mainly to the fact that, petroleum import bills were not claimed through the ACU mechanism as an Iranian line of credit was available during the year. Rupee value of net settlements made under the ACU mechanism during 2009 also declined by around 50 per cent to Rs. 159 billion, when compared with 2008.

**Table II-13**  
**Trade and ACU Transactions of Sri Lanka**  
**with other ACU countries**

|  | Rs. bn |       |
|--|--------|-------|
|  | 2008   | 2009  |
| Total transactions channelled through ACU        | 363.3  | 190.7 |
| Sri Lanka's exports to other ACU countries       | 72.3   | 63.2  |
| Sri Lanka's imports from other ACU countries     | 525.8  | 337.5 |
| Sri Lanka's total trade with other ACU countries | 598.1  | 400.7 |
| Net ACU Settlement                               | 315.2  | 158.5 |

Source: Central Bank of Sri Lanka

The 38th meeting of the ACU Board of Directors was held in Colombo on 16th June 2009. The meeting was presided over by the Governor of the CBSL as the Chairman of the ACU Board of Directors for the year 2009/2010, taking the succession turn as per the ACU procedure rules. At the meeting, the Board of Directors unanimously approved the following recommendations.

1. To expand the ACU membership - In this respect, it was decided to set up a technical committee to evaluate the potential members. The Reserve Bank of India (RBI) volunteered to convene the committee and member countries were requested to develop an evaluation procedure to enable the ACU Secretariat to take appropriate steps towards expansion of the ACU.
2. To improve the ACU mechanism - It was decided that the Technical Committee convened by the RBI would also study the future role of the ACU bearing in mind inter alia, the need for expanding the scope of the ACU beyond its current scope of a payments and settlements system, enhancing the financial and



monetary co-operation among economic needs, in particular exploring the advisability and feasibility of setting up an Asian Reserve Bank and promotion of trade relations among the members.

3. To introduce e-vouchers and statements which are digitally signed in order to cease dispatching vouchers and statements through mail.
4. To include a six month time period for dispute resolution in the agreement establishing the ACU and procedure rules.
5. To admit the Maldives Monetary Authority to the ACU membership and commence ACU operations with the Maldives from 01 January 2010.

The 39th Meeting of the Board of Directors of the ACU is scheduled to be held in Bhutan in 2010. Following the principles of rotation, during 2010, the Chairmanship of the ACU will be held by the Managing Director, Royal Monetary Authority of Bhutan and the Vice Chairmanship by the Governor, RBI.

### 17.6 Payment system policy and oversight

The PSD continued its activities to ensure payments and settlements system stability to achieve the overall objective of financial system stability of the country throughout the year. Having considered the importance of standardizing the payment cards industry in the country and in line with the international best practices and standards, the PSD, in consultation with the Attorney General's Department and the Legal Draftsman, took steps to obtain the authorization by His Excellency the President for the "Service Providers of Payment Cards Regulations No. 1 of 2009" (Regulations) effective from 31 July, 2009. These regulations provide the CBSL, as the regulator of the payments systems, with the necessary authority to regulate and direct service providers engaged in payment card businesses and require each service provider of payment cards operating in Sri Lanka to obtain a licence from the CBSL to perform their functions. Payment card definition given in the Regulations covers debit cards, charge cards, credit cards and stored value cards in the form of any card, plate, coupon book or other device, including a code or any other means of access to an account which stored value or credit that may be used from time to time to obtain money or to make payments. The Regulations authorized the CBSL, as the supervisory authority of such service providers, to issue directions, directives, guidelines, conditions, circulars, rules and instructions to the payment card service providers as and when necessary.

As per the Regulations, no persons shall engage in or function or cause another person to be engaged in or function as a service provider of payment cards except under the authority and in accordance with the terms and conditions of a licence issued by the CBSL. The Regulations provide a six month time period from the

effective date of the Regulations, for existing eligible persons to submit applications to obtain licences to act as service providers of payment cards.

It is expected to issue licences to successful service providers of payment cards as per the Regulations, during the first quarter of 2010. Further, in order to provide all service providers with a level playing field in the industry and to enhance the level of security and efficiency and as a measure to protect customers, the PSD expects to issue guidelines to service providers engaged in payment card business. Having considered the importance of the credit card businesses, operating guidelines for credit card issuers were prepared by the PSD with the assistance of the Payment Cards Industry Association of Sri Lanka (PCIASL). The credit card operational guidelines are expected to be issued to credit card issuers during the first quarter of 2010 with the objective of achieving safe, secure and efficient operations of the credit cards business in the country. Similarly, guidelines for other types of payment cards, including mobile payments, will also be issued depending on the requirement.

As the operator of the LankaSettle system, the CBSL is entrusted with the designing and updating of the system rules for the system under the provisions of the Monetary Law Act. The PSD updated the Lanka Settle System Rules in 2009 which was first issued in August 2003, at the commencement of the RTGS system operations. The revision includes all amendments made to the System Rules after the first release and system enhancements made during this period. The System Rules document was published in the CBSL website for easy access and as fulfillment of the core principles for operations of a systemically important payments system. The PSD closely monitored the adherence of participants to the System Rules as in the past.

In order to ensure the operational reliability of payments and settlements systems, the PSD continued its business continuity policy in 2009, by overseeing and making recommendations to improve the Business Continuity Plans (BCPs) and Disaster Recovery Sites (DRSs) of all participants. Phase I of BCP and DRS assessments of all Licensed Commercial Banks (LCBs), 3 Primary Dealers, and Lanka Financial Services Bureau (LFSB) were completed with the assistance of Bank Supervision Department, Information Technology Department and Public Debt Department of the CBSL.

To ensure adherence of LCBs to the General Direction issued in 2006 on Cheque Imaging and Truncation (CIT) System, the PSD imposed several measures on LCBs and instructed them to report the progress on adhering to T+1 rule on cheque realization. In order to ensure that customers receive the benefits of the T+1 rule, the PSD with the assistance of Statistics Department and Regional Offices of the CBSL conducted an island-wide (except

Northern and Eastern provinces) customer survey on cheque realization in 2009. Based on the results of the survey, which is scheduled to be finalized in early 2010, it is expected to implement further corrective measures to ensure that all banks fully comply with the T+1 rule.

Establishment of Sri Lanka's first Certification Authority (CA) in May 2009, by the LankaClear Pvt. Ltd, with the authorization of the CBSL, under the brand name of "LankaSign" to issue digital certificates that can be used for the purpose of signing and encrypting electronic transactions, was another milestone in the financial industry, providing greater value to the Payments and Settlements Systems in Sri Lanka. With the introduction of electronic means as payment instruments, it is required to maintain security of such transactions at every stage of the transmission. Considering the importance of maintaining the privacy of transactions and authentication during the transmission of electronic transactions, the concept of "Certificate Authority" or "Certification Authority", to authorize electronic transactions, was established in e-commerce applications and Payments and Settlements Systems in order to provide legal protection. This is expected to promote public confidence, integrity and reliability of data messages, electronic documents, electronic records or other communications and non-repudiation in electronic transactions and electronic data transfers among the financial institutions.

The PSD continued its information dissemination during the year 2009 as well by re-designing the quarterly Payments Bulletin in 2009 to provide a professional outlook, in line with international standards and best practices. In order to educate the general public, including students and staff of banks on payment systems in Sri Lanka, PSD continued its awareness programmes during the year.

### 17.7 SAARC Payments Initiative (SPI)

In 2009, the PSD continued to operate the SPI Secretariat on behalf of the member countries. Two volumes of the SAARC Payments Bulletin were published and website of the SPI was maintained and updated, in order to increase awareness on the progress of the SAARC Payments Council (SPC) and SPI. Two meetings were held in Kathmandu, Nepal and Thimphu, Bhutan during the year and the PSD continued to attend to all secretarial work and meeting arrangements on behalf of the host countries. As part of the payment initiative, education programmes for staff from Bangladesh Bank and Royal Monetary Authority of Bhutan were arranged.

## 18. POLICY REVIEW AND MONITORING

The Policy Review & Monitoring Department (PRMD) has the responsibility of (a) coordinating the strategic planning process and updating the Strategic Plan of the CBSL annually for the next five year period (b) monitoring

progress of departments in the implementation of strategic plan, and (c) conducting reviews and studies on policies adopted by the CBSL.

### (a) Coordinating the strategic planning process:

The PRMD organized a two-day retreat with the participation of all Heads of the Department, their representatives and senior management at Taj Exotica Hotel, Bentota during 18 – 20 September 2009 to review the Strategic Plan (SP) and update it for the period 2010 – 2014. The new Strategic Plan under the theme "Fast Track Prosperity" was the fourth in the series of SPs commenced in 2007. Under the last SP for 2009–2013, the CBSL recorded an average success ratio of 91 per cent. In the new SP for 2010–2014, an attempt was made to make the goals SMART i.e. Specific, Measurable, Action Oriented, Realistic and Time and Resource Constrained. SP identified strategic objectives, goals and mechanism for achieving goals together with Key Performance Indicators under seven clusters, i.e., Economic and Price Stability, Financial System Stability, Currency Issues and Management, Agency Services, Human Resource Management and Development Services, Corporate Services, and Policy Review and Monitoring.

### (b) Monitoring the activities of the departments under the Strategic Plan.

Pre-implementation sessions and quarterly monitoring of departmental performance were the two main aspects of the monitoring process. A series of cluster-wise awareness sessions were conducted on the SP at the beginning of the year, to get the entire staff involved in the implementation of the plan. This enabled the staff to appraise their positions within the plan and make a better contribution.

A close monitoring was one of the key factors for the success of the SPs. Under a quarterly monitoring process, progress of each department against the relevant action plan and the outcome was evaluated and reported to the Strategic Plan Review Committee (SPRC) which comprised of the corporate management of the CBSL. This enabled the management to take a view on the progress and initiate necessary action to ensure timely completion of the plan.

### (c) Policy review and studies

Several reviews were conducted in the areas of foreign exchange reserves, public debt management and human resources management in the CBSL. Areas of policy reviews were completed with the concurrence of the management. In addition, the PRMD has commenced preparing an exhaustive list of policies of the departments in the CBSL. During the year, the on-line e-policy and procedure library was launched with the technical assistance of IT Department to store soft copies of policy related documents. This library is accessible through the CBSL's email system and contains soft copies of legislation relating to operations of the CBSL, regulations, circulars and directions issued, and publications of the CBSL.

## Box II-1

## Strategic Planning of the Central Bank of Sri Lanka

Strategic planning is a process by which an organization formulates, implements and evaluates strategies which enable that organization to achieve its goals and objectives focussed on its vision. Strategic planning determines where an organization should be heading over the medium to long-term, the mechanisms and strategies used to get there and evaluates whether the organization has moved towards that direction. As quoted by two well known strategic planning experts, Joel Rose and Michael Kami, “without a strategy, an organization is like a ship without a rudder, going around in circles. It is like a tramp; it has no place to go” (Fred R David, 2008).

The benefits of strategic planning are immense. Strategic planning allows an organization to be more proactive and dynamic and initiates its own path and empowers people. Through involvement in the strategic planning process, managers and employees become committed to supporting the organization. In the meantime, strategic planning allows an organization to be more proactive and have a better control over its activities. It provides clear focus of the organization, producing greater efficiency and productivity while building team spirit among the staff. Having recognized these principal advantages, the Central Bank of Sri Lanka (CBSL) has taken a vital step to design and document its strategic plan in 2006.

The CBSL designed its first strategic plan for a five year period of 2007-2011. With that for the first time in its history, the CBSL developed a vision and mission for the Bank, formulated strategies and actions focussing its vision and identified key performance indicators to evaluate the extent of achievements. Since then, the CBSL has successfully completed three cycles of strategic plans with an overall success ratio of more than 90 per cent. The current strategic plan for the period of 2010-2014 is the fourth in the series.

In practice, the strategic planning process consists of three stages: *strategy formulation*, *strategy implementation* and *strategy evaluation*. Strategy formulation includes developing a vision and mission, identifying an organization’s external opportunities and risks, determining internal strengths and mechanisms, establishing long-term goals and generating strategies to pursue the vision. Strategy implementation requires an organization to establish annual objectives, devise policies, motivate employees and allocate required resources so that formulated strategies can be executed. Strategy implementation also includes developing a strategy supportive culture, creating an effective organizational structure, preparing budgets, developing information systems and linking employee remuneration to organizational performance. In this “actions stage” of strategic management, it is essential to mobilize employees and managers to put formulated strategies into action. Strategy evaluation is the final and the most important stage in strategic management. At this stage, the manager could know whether the strategies are working well and whether the institution is moving towards its

vision. Reviewing external and internal factors that are the bases for current strategy, measuring performance and taking corrective actions are the three important aspects that managers need to pursue at this stage (Fred R. David, 2008). The key techniques used in strategic planning are SWOT analysis (Strengths, Weaknesses, Opportunities and Threats), PEST analysis (Political, Economic, Social and Technological), STEER analysis (Socio-cultural, Technological, Economic, Ecological, and Regulatory factors), and EPISTEL (Environment, Political, Informatics, Social, Technological, Economic and Legal).

The CBSL has implemented a series of steps to design and monitor the strategic plan of the CBSL since 2006. At the commencement, in order to coordinate, review and monitor the activities of strategic planning process annually, a Policy Review and Monitoring Department (PRMD) was established in 2007. The key components of the current strategic plan (2010-2014) includes goals, mechanism to achieve these goals, key performance indicators and strategic objectives under seven different clusters viz., economic and price stability, financial system stability, currency issues and management, agency services, human resource management and development, corporate services, and policy review and monitoring. Considering the scope of work, legal empowerment and the availability of resources, the departments of the Bank currently design their departmental action plans for a medium term of five years. These initial plans are discussed at an Annual Retreat with the participation of the Governor, top management and all Heads of Departments of the CBSL. After considering and analyzing the internal and external risks and emerging challenges to be faced, initial strategic plans are revised, modified and restructured by the relevant Heads of Departments at the Retreat. The progress of the strategic plan is monitored by the PRMD by conducting quarterly progress review meetings with relevant Heads of Departments. The PRMD reports to the Strategic Planning Review Committee (SPRC) which is chaired by the Governor and consists of corporate management. The decisions of the SPRC are communicated to the departments for action on any delays or drawbacks. This process was proved to be highly successful as seen from the performance indicators. The principal reasons for the success of strategic planning can be attributed to improved awareness among the staff about the strategic planning and the continuous monitoring process.

The theme of the initial two strategic plans was “Achieving Prosperity in Sri Lanka,” while the third was “Challenging the Comfort Zone”. The current strategic plan for 2010-2014 is based on the theme “Fast Track Prosperity”. The progress of the strategic planning process clearly indicates that the CBSL is moving towards achieving its vision i.e., “a Credible and Dynamic Central Bank contributing to the prosperity of Sri Lanka.”

David, Fred R. (2008), *Strategic Management* (12th Edition), PHI Learning Private Limited, New Delhi.  
<http://www.rbi.org.in/scripts/PublicationReportDetails.aspx?ID=460>

## 19. PREMISES

The Premises Department (PD) in 2009, continued to carry out new construction works, maintenance and upkeep of the CBSL's premises and oversight that the physical assets related to the premises and its environment are properly utilized and safeguarded. In addition, the PD also provided support services on transport, communication facilities and managing the holiday bungalows of the CBSL for its officers.

The PD completed the construction of the new provincial office building in Matale at a cost of Rs. 50 million. The two-storeyed office building, having a floor area of approximately 11,000 square feet, includes a modern auditorium with a seating capacity for 160 persons. The Provincial Office is located at No. 805, Trincomalee Street, Mandandawala, Matale. The Provincial Office operations were shifted to the new building on 1st February 2009.

Part of the Matara Provincial Office had to be demolished to accommodate the widening of the Anagarika Dharmapala Mawatha. Accordingly, a new superstructure was constructed to support the upper floors and renovations were undertaken at a cost of Rs. 30 million. The new superstructure was handed over on 1st March 2009, to conduct the Bank's provincial level operations in the Southern region.

The PD commenced the construction of a new Observation Bungalow and a Beat Office in Somawathiya Vihara area in March 2009. The construction of the two-storeyed Observation Bungalow and the three-storeyed Beat Office having a total floor area of approximately 6,000 square feet is scheduled to be completed in March 2010.

Modernization of the Currency Museum at Centre for Banking Studies (CBS) was carried out during the year. Improvements were also made to the surrounding of the CBS and the refurbishment and upgrading of the auditorium as a part of the upgrading works to elevate the CBS to a modern international training centre for the SAARC region.

Modifications were done to the CVCS machine room of the Currency Department to minimize the dust and odor in the area. Together with in-house professional expertise, the PD was able to improve the working environment of the Currency Department by satisfactorily completing this project and uplifting the health condition of its employees.

The PD in consultation with the Archaeological Department satisfactorily completed the internal repair and painting of the clock tower at Chatham Street Clock Tower in 2009.

Lloyds building at Sir Baron Jayathilake Mawatha was purchased by the CBSL to find additional office space required for expansion and renovation was started. The building will be occupied by the EPF Department after

the completion of renovation. Project management and design of this renovation project are totally undertaken by the PD.

National Mutual Assurance Building (Former CWE sport complex) was also purchased by the CBSL.

PD initiated preliminary works to establish a provincial office in Eastern province. Arrangements were made to acquire a 5 acre land in Trincomalee district from the Divisional Secretariat Trincomalee and formal documents of transferring the land is awaited to commence the preliminary works of constructing a provincial office in that land.

The PD continued to maintain the external beautification of all the premises of CBSL.

## 20. PROVINCIAL OFFICES MONITORING

One of the strategic objectives of the Provincial Offices (POs) of the CBSL is to extend financial support to productive sectors to achieve balanced development at provincial levels. In order to assure the development outcome, the CBSL has taken several steps for the improvement of the functions/performance of the POs on target oriented actions. Accordingly, a separate department, i.e. Provincial Offices Monitoring Department (POMD) was established in 2009, with a view to monitoring the performance of POs in line with policy objectives of the CBSL. Further, in terms of Section 7 of the Monetary Law Act, the CBSL intends to establish more POs to expand the development activities in a wider geographical area that needs assistance but not coming under existing POs. Arrangements have been made to establish two POs at Trincomalee and in the Northern Province during 2010.

The expanded role of POs at provincial levels includes the implementation of credit schemes operated by the CBSL, conduct of awareness and skills development programmes for prospective entrepreneurs, addressing of development issues and increase of income generating capacity of low income groups through the promotion of financial inclusiveness among them.

### Awareness programmes and skills development programmes conducted

Awareness programmes have been conducted among the general public by the POs on different subjects such as development credit schemes introduced by the CBSL, forward sales contracts (FSCs), investment on government securities, promotion of saving habits, illegal financial businesses, forged currency notes and other general and current economic issues which are beneficial for both entrepreneurs and the bankers as well. Skills development programmes have been conducted covering a wide range of subject areas such as home-gardening, seeds production, post-harvesting techniques and scientific dairy farming in

**Table II-14**  
**Progress of Programmes Conducted by Provincial Offices**  
**During the Year 2009**

| Name of Provincial Office | Awareness Programmes Conducted |                            | Skills Development Programmes Conducted |                            |
|---------------------------|--------------------------------|----------------------------|---|----------------------------|
|                           | No. of Programmes              | No. of People Participated | No. of Programmes                       | No. of People Participated |
| Southern Province         | 32                             | 825                        | 09                                      | 345                        |
| North-Central Province    | 131                            | 5124                       | 107                                     | 2554                       |
| Central Province          | 80                             | 3393                       | 50                                      | 1397                       |
| All POs                   | 243                            | 9342                       | 166                                     | 4296                       |

association with relevant institutions in the provinces. The progress of programmes conducted by the POs during the year 2009 is given in the Table II-14

#### **Other Activities Carried out by the POs**

During the year 2009, the PO of the North-Central Province facilitated the maize cultivators to enter into 21,635 FSCs amounting to Rs.3,357 million while the PO of the Central Province facilitated farmers of cultivation of paddy, soya beans and b-onions to enter into 1706 FSCs worth of Rs.223 million with selected buyers. The POs have coordinated with the government and private sector organizations to promote scientific farming practices, including the use of high-yielding varieties of seeds, among other things, to increase crop productivity in the provinces. Similarly, the POs also coordinated the veterinary services in the livestock development sector with a view to increasing local liquid milk production in the provinces. The POs continued the collection of provincial data/information and updated the socio-economic data base of the respective provinces during the year.

#### **Logistic Support**

The logistic support extended by POs to the CBSL includes the arrangement of seminars and awareness programmes, attending to member-inquiries on Employees' Provident Fund, sales of commemorative coins and publications of the CBSL and conduct of coin collection programmes. Moreover, the POs also assisted in conducting surveys and field-level investigations in the provinces, on the request of the other departments of the CBSL by deploying the staff attached to the POs.

### **21. PUBLIC DEBT**

The Public Debt Department (PDD) on behalf of the government continued to carry out responsibilities of managing public debt in a prudent manner mobilizing resources at the lowest possible cost and maintaining the risk of public debt at a prudent level and servicing of public debt on time with 100 percent accuracy. In addition, PDD strengthened public debt policy by improving

accountability and transparency, maintained the stability of primary dealer (PD) system and took measures to develop the market for government securities in domestic and international markets. During the year 2009, PDD effectively implemented the debt management strategy approved by the Monetary Board in order to meet the borrowing requirement of the government. Accordingly, PDD issued existing debt instruments as well as new instruments considering different market segments and investors' appetite. As such, during the year, PDD continued to issue short, medium and long-term (10 year) securities. Sri Lanka's second 5 year international sovereign bond was issued during the year with a remarkable success and the issue was over-subscribed by more than thirteen times, one of the highest over-subscription of any sovereign US dollar bond offer in 2009. In addition, the debt management strategy in 2009 focused on the effective implementation of risk management techniques, to operate the medium term public debt management strategy. The PDD also implemented the diversification of the PD system and strengthened the regulatory framework for PDs, conducting investor awareness programs to promote government securities, opening the rupee denominated Treasury bill and Treasury bond market for Sri Lankan diaspora and migrant workforce.

As announced in the CBSL Road Map for 2009 and Beyond, the PDD focused more on effective execution of its debt management strategy. During the year, duration of domestic debt portfolio improved to 1.8 years, from 1.6 years in 2008, resulting from strategies adopted by the PDD, shifting short-term debt maturities to medium and long-term maturities. In order to improve the maturity structure of the government securities portfolio through the availability of a comprehensive yield curve, the PDD established a long-term yield curve up to 10 years. However, as a result of excessive borrowings of the government to strengthen the national security during the first half of the year and revenue shortfall due to low domestic economic activities in the wake of the global crisis over the year, it was difficult to limit the government borrowing within the initial target set for the year. Accordingly, the originally planned borrowing limit was revised towards the end of

the year. It is important to note that this was a common experience even in advanced economies in 2009, where the government debt has increased substantially due to the global financial crisis.

The average interest rate in the domestic market for government securities was around 19.0 per cent at the beginning of the year due to liquidity shortfall in the market arising from the withdrawal of foreign investment in rupee denominated government securities i.e., Treasury bills and Treasury bonds. Subsequently, with the relaxation of tight monetary policy in line with the decline of inflation and inflation expectations and renewed investor confidence in the economy, interest rate structure in domestic market showed a downward shift between 554 bps and 991 bps, thereby reducing the borrowing cost of the government.

As in the past, the PDD was able to preserve its unblemished non-defaulting stand of servicing public debt, servicing government debt (including both domestic and foreign debt) on time with 100 per cent accuracy.

With the positive outlook brought about by the end of the civil conflict in May 2009 and renewed investor confidence after the approval of SBA facility by the IMF in July 2009, the PDD was able to mobilize US dollars 1,768 million (Rs.185 billion) in 2009, through the foreign investments in rupee denominated Treasury bills and Treasury bonds. With these significant inflows of foreign investments, the PDD retired a considerable portion of high-cost short-term government debt.

During the year, the PDD took action to continuously provide up-to-date information to the market with a view to improving its credibility, accountability and transparency in public debt management operations. Reiterating the importance of these features to develop a sound debt management system, the PDD continuously updated the CBSL web site, and published monthly data bulletins and its annual publication on Public Debt Management in Sri Lanka.

The PDD took several measures to maintain the stability of the PD system by conducting a number of regular on-site examinations and continuous off-site surveillance in 2009. Further, to reduce business concentration risk faced by PDs, the first phase of the diversification of PD activities was introduced during the year.

In order to ensure timely recording of all transactions of government securities in the Central Depository System (CDS), the PDD closely monitored and supervised records maintained at the CDS. Resulting from this, the PDD received only a few complaints against non-recording of transactions of government securities at the CDS during the year.

Realizing the need of developing a more competitive, dynamic and liquid securities market, the PDD took

several efforts to broaden and diversify the investor base during the year by conducting awareness programs island-wide as well as internationally. For this purpose, the PDD published advertisements in national newspapers, conducted seminars island-wide, participated in several tv/ radio programs and participated in exhibitions organized by other ministries. In addition, the PDD conducted 21 overseas investor awareness programs in 2009, aiming at Sri Lankan diasporas and foreign investors.

## 21.1 Developments in 2009

### (a) Borrowing target and strategy

In terms of the Appropriation Act No.43 of 2008, Parliament's approved total gross borrowing limit of the government for 2009, in terms of book value, was Rs. 840 billion, including Rs. 25 billion provision for unforeseen contingencies to be financed during the year. However, due to the unexpected increase in government funding requirements and significant shortfall of revenue collection, the actual annual borrowings deviated significantly from the originally planned amount. Therefore, the total gross borrowing limit was increased to Rs. 1,050 billion in October 2009. Of this revised borrowing limit, Rs. 724 billion was expected to be financed from domestic sources while the balance Rs. 326 billion was to be mobilized through foreign sources. However, during the first half of the year 2009, adverse impact of the global financial crisis made it difficult to raise external funds and hence, government borrowings were mainly carried out through domestic sources. However, with the renewed investor confidence after end to the conflict in May 2009 and receiving the SBA facility from the IMF in July 2009, a remarkable development was observed in foreign investments in government securities. Foreign investments in government securities recorded the highest level of Rs. 185 billion (in face value terms) as at end December 2009 with total inflows of Rs. 151 billion during the year 2009. Further, the PDD was able to offer Sri Lanka's second international sovereign bond issue of US dollars 500 million with great success, by adding Rs. 57 billion to the borrowing program. With these funds, the PDD was able to retire a significant portion of high cost short-term government debt. During the second half of the year, external funds were received from foreign sources as expected and hence, the borrowings were shifted from domestic to foreign sources. Accordingly, the total gross domestic and foreign borrowings in 2009 amounted Rs. 643 billion and Rs. 356 billion, respectively. This included borrowings through project/programme loans of Rs.147 billion from foreign concessional sources in 2009.

The interest rates in the domestic market moved downward significantly during the year 2009. Monetary policy measures adopted in line with the decline of inflation to stimulate economic activities, lower inflation expectations of investors, foreign currency inflows through foreign investment in government securities, improved liquidity

situation in the market, and debt management strategies adopted by the PDD were the key factors that contributed to lower the interest rate structure in the government securities market. With the reduction of interest rate structure, the PDD was able to gradually shift from short-term domestic debt instruments to medium to long-term debt instruments. Accordingly, in 2009, Rs. 49 billion was raised through Treasury bills and Rs. 510 billion was raised through Treasury bonds. In addition, Rs. 62 billion (US dollars 541 million) was borrowed through SLDBs in 2009. Further, continuing the strategy of reducing non-marketable debt from the domestic debt, borrowings through rupee loans were limited, thereby reducing the outstanding amount of rupee loans by Rs. 17.7 billion in 2009.

In 2009, the PDD continued its borrowing strategy to ease the monthly bunching pressure by limiting issue of 91 day Treasury bills and increasing the issuance of 182 day and 364 day Treasury bills. Accordingly, the issuance of Treasury bills with less than 3 month maturity was reduced to 21 per cent of the total Treasury bill issues in 2009 from 32 per cent in 2008. The issuance of Treasury bills of 6 months and 12 months maturities was increased to 34 per cent and 44 per cent of total issuance from 28 per cent and 41 per cent in 2008, respectively. Further, with the significant reduction of interest rates in government securities, the PDD was able to successfully adopt its borrowing strategy of issuing Treasury bonds with the medium to long-term maturities and establish a long term yield curve up to 10 years. Accordingly, the volume of Treasury bonds issued with maturities above 3 years was increased to 50 per cent of total Treasury bonds issued in 2009 from 29 per cent in 2008. The volume of Treasury bonds issued with 6 year maturities was increased to above 20 per cent of the total Treasury bonds issued in 2009.

#### **(b) Issuance of debt instruments**

The PDD continued to conduct primary market operations by issuing government securities to raise funds required for budgetary operations. As in the previous year, issuance of Treasury bills and Treasury bonds was done through both auctions and private placements, adopting a dual fund raising approach. In the Treasury bill program, PDD issued Rs. 821 billion worth of Treasury bills during 2009. Of this total, Rs. 749 billion was re-issued for maturing Treasury bills, while the balance Rs. 72 billion was new issues. There were 52 Treasury bill auctions during the year through which Rs. 416 billion was mobilized, while Rs. 215 billion was raised through direct placements with market players. The amount of funds mobilized through direct placements was decreased by 37 per cent, while the amount of funds mobilized through auctions was increased by 64 per cent compared with the previous year.

In the Treasury bond program, total funds mobilized in 2009 amounted to Rs. 701 billion. The PDD conducted 81

auctions during the year, of which bids at 17 auctions were totally rejected due to unacceptably high yield rates quoted by the market. As a result, only Rs. 52 billion was able to be mobilized through auctions, while Rs. 649 billion was raised through direct placements.

The PDD also conducted 4 SLDB auctions to roll over maturing bonds. The total amount of funds mobilized through auctions and private placements amounted to US dollars 541.05 million. These funds were raised with a maturity period ranging from two to three years at interest rates of six months LIBOR plus weighted average margin ranging from 540 bps to 425 bps.

Further, US dollars 100 million was raised through offshore banking units (OBUs) to service maturing foreign currency debt. These funds were raised at a maturity period of 3 years and at interest rates of three months LIBOR plus 300 bps with a floor rate of 400 bps.

To complement the borrowing needs, the PDD issued the second international sovereign bond for US dollars 500 million at a 7.40 per cent fixed coupon rate with a five year maturity period. The positive economic outlook achieved mainly after the ending of the conflict and upgrading of Sri Lanka's sovereign rating by the rating agencies contributed to achieving this reduced margin compared to the first international sovereign bond in which the margin was 8.40 per cent, in 2007.

#### **(c) Debt service payments**

During the year 2009, the PDD serviced both foreign and domestic loans amounting to Rs. 800 billion. Out of the total debt serviced, Rs. 300 billion was for the payment of interest while the principal repayments were Rs. 500 billion. Total domestic loans serviced in 2009 amounted to Rs. 590 billion while the foreign debt serviced amounted to Rs. 210 billion. In addition, maturing Treasury bills amounting to Rs. 667 billion were re-issued during the year.

In addition to the routine debt servicing function, the PDD completed a comprehensive management audit to streamline the debt servicing functions. The audit findings were communicated to the External Resources Department, the official external resources mobilizer of the government.

#### **(d) Yield rates and secondary market performance**

Yields rates of Treasury bills and Treasury bonds fell significantly by a range from 554 bps to 991 bps during the year. This was in line with the monetary policy stance undertaken by the CBSL in response to emerging macroeconomic conditions. The shorter end of the yield curve, i.e., 3 months to 1 year, dropped by 968 bps to 991 bps while 2 year yields fell by 946 bps to 10.68 per cent, 4 year yields fell by 721 bps to 12.01 per cent, 6 year yields

fell by 680 bps to 12.08 per cent and 10 year yield by 554 bps to 12.11 per cent.

Renewed foreign investor participation also contributed to this significant drop in market yield rates. The drop in yield rates was seen both in the primary market and secondary markets. However, during the latter part of the year, the yields at the shorter end (3 months, 6 months and 1 year) increased marginally reversing the trend seen so far during the year. Many investors claim that the significant drop in yield rates, particularly in the shorter end (3 months to 1 year), was unacceptable and the marginal increase in the yields at the primary auction was seen as purely a correction taking place.

#### **(e) Scripless Securities Settlement System (SSSS) and the Central Depository System (CDS)-LankaSecure**

During 2009, the PDD was able to maintain the LankaSecure operations smoothly with its participants which include 21 licensed commercial banks (LCBs), 8 non-bank primary dealers, Employees' Provident Fund and Central Depository Systems (Pvt.) Ltd. (CDS (Pvt.) Ltd.) of the Colombo Stock Exchange. The value of transactions took place through SSSS increased by 25.5 per cent to Rs 32.69 trillion. The number of accounts maintained at Central Depository System (CDS) increased further to 64,680 in 2009 from 56,041 in 2008, as a result of the expansion of the investor base due to aggressive investor awareness campaign. Introduction of the CBSL wide area network based application in 2007 to record up to Rs. 5 million repositioning transitions free of charge may have also attributed to this increase. LankaSecure continued to dispatch its statements to the investors to increase their confidence level. The LankaSecureNet facility provided online view facility to the investor's CDS account free of charge.

#### **(f) Primary dealer supervision**

The PDD continued with its primary dealer supervision activities during the year through onsite examinations and offsite surveillance ensuring stability in the PD system, amidst numerous challenges in the financial sector of the country. In 2009, six regular onsite examinations and four spot examinations were conducted while continuous off-site surveillance activities were carried out. The regular onsite examinations focused on an assessment of PD's exposure to risks including market risk, liquidity risk, operational risks and other risks, management of those risks at prudent levels and adequacy of resources, i.e., earnings, capital and management. To maintain a continued direct dialogue between the authorities and the market participants, the PDD continued to hold regular meetings with CEOs of PDs throughout the year. The CEOs of PDs were informed of the current developments in the economy and in the international financial markets, and also of their own performance focusing more on risk

factors, at these meetings. CEOs of PDs also contributed at these meetings by discussing their views about the market, which is essential for the development of the industry.

A policy decision was taken to diversify the PD system considering their high exposure to market risk being engaged in a single product market. The first phase of diversification was implemented on 02 December, 2009. Accordingly, in addition to the activities related to government securities, PDs are now allowed to engage in services to earn a fee income, such as portfolio management services, project appraisal services, loan syndication services, merger and acquisition advisory services, consultancy services and to invest in ordinary shares or debentures of its own group of companies of banking and finance in nature which are regulated by a regulatory authority in Sri Lanka, subject to certain conditions imposed by the PDD. The regulations made under the Registered Stock and Securities Ordinance and the Local Treasury Bills Ordinance were amended during the year to enable the said diversification of PD activities.

#### **(g) Government securities market development**

With a view to expanding the investor base for government securities (GS), thereby increasing the competition in the GS market, the PDD continued its island-wide investor awareness program. Accordingly, the investor awareness programmes were conducted through electronic media, such as tv and radio, and also through conducting seminars, workshops, conferences and forums. During the year, the PDD organized 42 public investor awareness programs, 83 radio programs jointly with regional services of Sri Lanka Broadcasting Corporation, 5 tv live discussions, and one month tv advertisement programme.

Further, the PDD participated in 4 exhibitions, 6 local forums and 21 overseas forums to improve the awareness of public on government securities. In addition, the PDD participated in 12 forums abroad to offer investment opportunities to foreigners.

## **22. REGIONAL DEVELOPMENT**

The Regional Development Department (RDD) continued to engage in activities aimed at promoting regional development initiatives through coordinating and facilitating credit delivery in the agriculture, livestock and micro, small & medium sector enterprises (MSME) sectors during the year 2009. Subsequent to the liberation of the Northern province in May 2009, the RDD initiated a comprehensive credit programme to ensure flow of funds to the Northern province. Meanwhile, the RDD persisted its development activities that commenced in the Eastern province in 2008 after the liberation of the area. In line with the declining trend in the interest rates, the RDD also took steps, with the patronage of the government of Sri Lanka, to reduce the on-lending rates under the schemes



implemented by the RDD with the interest subsidy support of the government. The revised interest rates will be effective from 01 January of 2010. In 2009, negotiations were concluded with the donors in respect of a new credit line for promotion of agri-business in the country.

During 2009, the RDD implemented/coordinated the under-mentioned loan schemes in respect of which either refinance was provided or interest subsidy was paid to participating financial institutions (PFIs).

### 22.1 Development of the Northern Province

With the liberation of the Northern province in May 2009, the RDD introduced a special loan scheme titled "The Awakening North" for the resumption of economic activities in agriculture, livestock, fisheries, micro and small enterprises, and trade and other self-employment projects in the Northern province. The objective of the scheme is to boost the livelihood development of the people in the Northern province. Under this loan scheme, a total sum of Rs. 3,000 million has been allocated to distribute among eligible borrowers at a concessionary rate of 9 per cent through PFIs operated in the province. The borrowers are entitled to receive a loan up to 90 per cent of the estimated cost of the project, up to a maximum of Rs. 200,000, per borrower. The CBSL provides refinance facilities to PFIs for 90 per cent of the amount disbursed to the borrowers. Further, borrowers are entitled for a grace period of six months. Under the scheme, the RDD has emphasized the need to assist Internally Displaced Persons (IDPs) to commence/re-start their livelihood and income-generating activities after resettlement. The RDD conducted several programmes to make the people in the five districts aware of credit facilities available under the scheme. Under the Awakening North loan scheme, which commenced operations in July 2009, PFIs have registered 8,226 loans amounting to Rs.1,190 million as at end December, 2009. Further, 4,335 loans amounting to Rs.586 million have been granted and the highest number (1,285) and value (Rs.215 million) of loans were given to trade and other self-employment activities. The other purposes of the loans

were for agriculture and related activities (Rs.141 million for 1,081 loans), livestock development (1,126 loans worth of Rs.136 million), micro and small enterprises (496 loans valued Rs. 56 million) and fisheries and related activities (365 loans worth of Rs.36 million).

### 22.2 Development of the Eastern province

The development activities initiated by the RDD in the Eastern province in 2008 after the liberation of the province continued in 2009 outreaching to a considerable number of beneficiaries who required financial assistance to commence/persist their economic and livelihood activities. In addition to the development programmes that were already in operation, the RDD established a revolving fund for the extension of refinance facilities to PFIs for resumption of economic activities in the Eastern province in June 2009. The new loan scheme provides facilities for activities in perennial crop cultivation, livestock, fisheries, trade, tourism and other self-employment projects in the province. The total amount of fund allocated for the scheme was Rs.1,000 million. The scheme provides refinance facilities up to 100 per cent of the eligible loans to a maximum limit of Rs.250,000 per borrower. Loans will be provided at a concessionary rate of 9 per cent with a grace period of six months for the eligible borrowers. Altogether, 2,262 loans, amounting of Rs.326 million, were registered under the scheme and 1,123 loans, valued to Rs.147 million have been granted as at end December 2009. In addition, the other development loan schemes that operated in the province continued with the peaceful atmosphere that prevailed in the Province during the year. The Construction Sector Development Project, which provides financing for purchase of machinery by companies registered under the Institute of Construction, Trade and Development for post-tsunami construction activities, actively engaged in related activities throughout the Province. The RDD also targeted to reach poor households in the Province under the Poverty Alleviation Microfinance Project (PAMP) with the assistance of identified Participating Agencies (PAs) and PFIs during the year. The number of beneficiaries enrolled under PAMP in

Table II-15  
FEATURES OF REGIONAL DEVELOPMENT LENDING PROGRAMMES  
IMPLEMENTED BY THE REGIONAL DEVELOPMENT DEPARTMENT

| Project and Implementation Period  | Source of Funds                | Broad Mission  | Fund Allocation | Annual Interest Rate to Borrowers | Recovery Rate where applicable |
|--|--------------------------------|--|-----------------|-----------------------------------|--------------------------------|
| <b>1</b> Agriculture and Animal Husbandry  |                                |  |                 |                                   |                                |
| 1.1 Second Perennial Crops Government Development Project of Sri Lanka Revolving Fund (SPCDPRF) (GOSL) 2006 - 2014 | Government of Sri Lanka (GOSL) | Commercialization of Perennial Crop Sector, increasing production, nursery development, post-harvest handling and processing activities and marketing.   | Rs.1.2 billion  | 9%                                | Around 90%                     |
| 1.2 Tea Development Project (Revolving Fund) - (TDPRF) 2006 - 2018   | GOSL                           | Increasing tea small holders' income on a sustainable basis and developing the necessary infrastructure required for meeting the requirements of the export market. In this connection, assistance is available basically to modernize tea factories to acquire HACCP certification. | Rs.1.1 billion  | 9%                                | Around 90%                     |

|          |  |   |  |   |   |                         |
|----------|--|---|--|---|---|-------------------------|
| 1.3      | New Comprehensive Rural Credit Scheme - (NCRCS) (Continuous Programme)                                 | PFI's own funds and Government Interest Subsidy | Provision of the working capital requirement of small farmers<br><ul style="list-style-type: none"> <li>• Short-term production loans</li> <li>• Production of seeds and plant material</li> <li>• Purchase of agricultural commodities under Forward Sales Contracts</li> </ul>   | Loans granted by PFI's using their own funds  | 12%   | Over 95%                |
| 1.4      | Agro-Livestock Development Project   | PFI's own funds and Government Subsidy          | In dairy farming, provision of capital for<br><ul style="list-style-type: none"> <li>• Construction of cattle sheds</li> <li>• Purchase of cows</li> <li>• Purchase of concentration feed, veterinary services &amp; drugs etc.</li> <li>• Cultivation of animal fodder</li> <li>• Construction of bio-gas units</li> <li>• Any other requirements recommended by veterinary surgeons</li> </ul> In Liquid Milk Processing Industries and Agro-based Industries, provision of funds for;<br><ul style="list-style-type: none"> <li>• Construction of industrial buildings/ Modernization</li> <li>• Purchase of modern machinery and equipment</li> <li>• Storage, cold rooms and transport services, other required services, purchase of equipment for maintenance of standards</li> </ul> | Loans granted by PFI's using their own funds. Total fund delivery is expected to be Rs.5,000 million                        | For small dairy project loans-12%<br>For milk and crop processing-14% | 90%                     |
| 1.5      | Krushi Navodaya Scheme   | PFI's own funds and Government Interest Subsidy | Provision of medium term loans for activities in agriculture and animal husbandry including agro related industry and micro and drip irrigation.   | Loans granted by PFI's using their own funds. Total fund delivery during operational period expected to be Rs.3,000 million | 12%   | Approximately 90%       |
| <b>2</b> | <b>Small and Medium Enterprises Sector</b>   |   |  |   |   |                         |
| 2.1      | Matale Regional Economic Advancement Project (Revolving Fund) - (MREAPRFS) (2007 - 2009)               | IFAD  | Raising the income of rural and farm families by providing funds for small and medium scale enterprises in the District.   | Rs.77 million   | 10%   | 87%                     |
| 2.2      | Sabaragamuwa Province Integrated Rural Development Project (Revolving Fund) - (SPIRDPRF) (2007 - 2010) | GOSL  | Upliftment of the living conditions of the people in the project area by promoting income-generating activities.   | Rs.100 million  | 10%   | 93%                     |
| 2.3      | Post-Tsunami Line of Credit - EIB Contract B Loan Scheme (2006 - 2014)                                 | EIB   | To assist the affected small and medium scale enterprises for resumption of business in the Tsunami affected districts.  | EURO 10 million   | 9%  | Over 90%                |
| 2.4      | Sushana Loan Scheme (Phase II)   | CBSL  | To assist micro, small and medium scale enterprises affected by the Tsunami to resume business   | Rs.500 million  | 6%  | Within the Grace Period |
| 2.5      | Construction Sector Development Project (2007 - 2015)  | AFD   | Financing the purchase of machinery by companies rated by the Institute of Construction, Trade and Development for post-tsunami reconstruction activities.   | EURO 10 million   | 9%  | Over 90%                |
| 2.6      | Awakening North special refinance loan scheme  | CBSL  | To assist IDPs and others settled in the provinces to re-start their economic activities.  | Rs.3 billion  | 9%  | Within the Grace Period |
| 2.7      | Revolving Fund for Development of Eastern Province "Rising East"                                       | CBSL  |  | Rs.1 billion  | 9%  | Within the Grace Period |

| 3 Micro Finance Sector |  |                |  |                   |               |                              |
|------------------------|--|----------------|--|-------------------|---------------|------------------------------|
| 3.1                    | Dry Zone Livelihood Support and Partnership Programme (2006 - 2012)              | IFAD           | Poverty alleviation and income generation among the poor farmers in the selected districts i.e. Monaragala, Kurunegala, Badulla and Anuradhapura.  | Rs.200 million    | 10%           | Within the Grace Period      |
| 3.2                    | Small Holder Plantation Entrepreneurship Development Programme (2007 - 2015)     | IFAD and USAID | Improving the livelihoods of marginalized small holders who are producing tea and other perennial crops in the mid-country region and poor upland food crop farmers in the intermediate zone of Monaragala district wishing to take up rubber cultivation.   | SDR 15.25 million | 9%            | Disbursement yet to commence |
| 3.3                    | Small Farmers & Landless Credit Project Revolving Fund                           | GOSL           | Setting up of an effective credit delivery mechanism for channelling formal credit to income generating activities for the rural poor to improve economic conditions and general welfare of the beneficiaries.   | Rs.267 million    | 16% - 20%     | Over 90%                     |
| 3.4                    | Poverty Alleviation Microfinance Project (Revolving Fund) (PAMPRF) (2009 - 2013) | GOSL           | Setting up of an effective credit delivery mechanism for channelling formal credit for income generating activities among the rural poor to improve the economic and social well-being of the beneficiaries.<br><br>Poverty eradication through promotion of income generating activities among them.<br><br>Organizing low-income groups to link them with formal banking system. | Rs.1,385 million  | 16%           | Over 90%                     |
| 3.5                    | Poverty Alleviation Microfinance Project II (PAMP II)                            | GOSL           | -do-   | JPY 2,100 million | 15.5% maximum | Within the Grace Period      |

the Eastern province stood at 27,086 as at the end 2009. Of these, 4,219 beneficiaries were granted loans to a total value of Rs.175 million.

### 22.3 Agriculture and animal husbandry sector

The Agro-Livestock Development Loan Scheme (ALDL), which was included in the Budget 2008 on the recommendation of CBSL, continued its operation in 2009 as well. This scheme was mainly aimed at promoting liquid milk production in the country. In addition to dairy farmers, medium scale investors in the private sector were also eligible to obtain finance facilities for construction of stores/factories, purchase of machinery, equipment and liquid milk processing plants, and purchase of machinery and equipment for agro-processing plants and agro-processing industries. During the year, PFIs were able to grant Rs.519.3 million among eligible recipients. This reflects an increase of 14 per cent over the previous year's performance.

New Comprehensive Rural Credit Scheme (NCRCS) continued the operations to provide facilities to farmers for cultivation of agricultural crops and to the buyers for purchasing of agricultural commodities under forward sales contracts. In Maha 2008/09, Rs.1,943 million was granted to 41,518 farmers as cultivation loans which was 23.6 per cent increase over the corresponding cultivation season of the previous year. Further, Rs.4,673 million was granted for purchasing of agricultural commodities reflecting an increase of 19.3 per cent over the previous year. In Yala season, however, the amount of loans granted

for both paddy cultivation and purchasing of agricultural commodities dropped by 13 per cent, to Rs.1,026 million and by 16.7 per cent to Rs.3,223 million, respectively. The drop in Yala season was primarily due to the decline in paddy production in the season by 28 per cent. Paddy represents over 60 per cent of the loans provided under the NCRCS. Meanwhile, under the Krushi Navodaya scheme, PFIs have granted medium and long-term credit to micro and small enterprises for agriculture related activities at a concessionary interest rate with interest subsidy support from the government. A fair quantum of loans under Krushi Navodaya were distributed in the Northern and Eastern provinces under this scheme.

### 22.4 Promoting SME Financing

Loan disbursement under the Construction Sector Development Project (CSDP) progressed satisfactorily during the year with refinance to the value of Rs.440 million being released to PFIs in 2009. Under the EIB Post Tsunami (Contract B) Line of Credit, refinance to the total value of Rs. 605.5 million was released during the year. The Sabaragamuwa Integrated Rural Development Project Revolving Fund (SIRDPRF) scheme and the Matale Regional Economic Advancement Programme Revolving Fund Scheme (MREAP-RF) also continued operations in the relevant districts in 2009. Under SPIRDP-RF, refinance was released in respect of loans amounting to a total value of Rs. 6.9 million during the year while under MREAP-RF, refinance was released in respect of loans amounting to Rs.54.9 million.

## 22.5 Poverty Alleviation

Poverty Alleviation Microfinance Project–Revolving Fund Scheme (PAMP – RF), and poverty alleviation programme funded by the Japan International Cooperation Agency (JICA), continued to operate throughout the country in 2009. The number of beneficiaries enrolled under PAMP II during the year was reported as 26,505. Out of these, 10,089 beneficiaries had been granted loans to the value of Rs.513.9 million to commence income generating activities. In January 2009, PAMP II scheme, funded by the JICA, commenced its operations. The objective of this project is to improve income levels of the poor and enhance an inclusive formal financial service for them by providing credit for income generating activities and increasing income generating opportunities and skills development of beneficiaries, thereby contributing to alleviate poverty, mitigating regional inequity and supporting peace building. This new scheme covers 14 districts including all 5 districts of Northern, 3 in Eastern, 4 districts in Uva and North Central provinces, Puttalam and Ratnapura districts. During the year, the number of beneficiaries registered under this scheme was 45,748 of which, 7,894 beneficiaries received loans to the value of Rs.351 million. Meanwhile, the Small Farmer and Landless Credit Project Revolving Fund (SFLCP), that intended to improve economic conditions and general welfare of the rural poor, also progressed in 2009 by granting of loans to the value of Rs.113.6 million among 4,534 beneficiaries.

## 22.6 Credit supplementation

The RDD continued operations of credit supplementation schemes and was engaged in collection of annual premia, processing of claim applications, payment or rejection of claims and follow-up post claim recoveries in respect of the 12 credit supplementation schemes during the year 2009. The total premia collected in 2009 under the schemes was Rs.58.8 million. The payment of credit guarantee claims was amounted to Rs.30.7 million during the year. Issue of new credit guarantee cover was limited to only the NCRCS scheme in 2009, as credit disbursement in respect of other schemes had been terminated.

## 23. SECRETARIAT

In 2009, the Secretariat Department (SD) facilitated efficient functioning of the CBSL through timely procurement of goods and services, continuous assessment and upgrading of systems and procedures, administering and implementing rules and regulations in respect of leave, superannuation funds, local and foreign travel etc.

The SD procured capital and non-capital goods and services amounting to Rs.170.8 million through tenders and other modes of procurements by assuring and maintaining quality, timeliness and competitive prices. As in the previous year, procurement planning was continued further to monitor the procurement management process

of the CBSL in order to streamline the timely supply of goods and services to the user departments. As a result, the SD was able to procure 91 per cent of the total procurement requirements of the Bank successfully during the year. In addition, the SD obtained a cost effective and comprehensive insurance cover for all CBSL properties. Meanwhile, the SD released the updated CBSL Manual containing the terms and conditions applicable to the CBSL service, operative from 1st July 2009. The CBSL Pension Scheme, Widows' and Orphans' Pension Fund (W&OP) and Widowers' and Orphans' Pension Fund (WR&OP) were administered by the SD. A total of 1,980 pensioners are enrolled under these schemes and the automation of existing database for these schemes was in progress with the development of a software programme for the release of provident fund.

During the year 2009, the activities of the Legal Department (LD) was attached to the SD to attend to the legal matters of an operational nature in the CBSL. Accordingly, the SD broadened its role of supporting the CBSL in achieving its objectives. This support was provided in formulating and implementing policies of the CBSL and asserting and defending the rights of the CBSL before courts and other legal fora.

Active assistance was given to prepare laws and by-laws in respect of the banking and financial sector. Challenging environment in the financial system was successfully handled with a mix of proactive and reactive measures aimed at achieving the ultimate objective of greater public interest.

In 2009, the SD coordinated and organized various religious and commemorative events and annual ceremonies such as long service ceremony and independence day ceremony.

## 24. SECURITY SERVICES

The Security Services Department (SSD) continued to strengthen the security of Central Bank of Sri Lanka (CBSL) with a view to protect its employees, buildings, properties, incoming visitors and currency consignments in transit. New cargo and baggage scanners were installed at the entrance to the CBSL head office at Janadhipathi Mawatha, Colombo and Centre for Banking Studies (CBS) at Rajagiriya. The new security gate and security office was built at the main entrance to the CBSL head office to strengthen its inner perimeter security. Construction of the security office at the CBS at Rajagiriya has made security duties more convenient and also has given a new outlook to its appearance.

Overseas training on advanced security management and accredited security managers programme were given to two Staff Officers of the SSD, with a view to update their commercial security knowledge. Further, twelve security personnel were provided with local training opportunities in their related fields. Eight fire drills and six awareness

programmes were conducted for the CBSL employees on handling emergency situations including fire fighting and first aid. Weapon training and firing for all security officers of the SSD were conducted with the assistance of the Sri Lanka Army instructors. Further, SSD actively took part in all drills held on testing business continuity plan for critical operations of the CBSL, in the year 2009.

## 25. STATISTICS AND FIELD SURVEYS

The Statistics Department (STD) continued its operations of collection, compilation, analysis and dissemination of data on national accounts, prices, wages, labour force, employment, and other socio-economic sectors in 2009 as well. The STD released socio-economic data and information regularly to the general public through the publication of weekly and monthly selected Economic Indicators in the press and CBSL website, and through the issuing of regular monthly press release on the behaviour of the consumer price index.

In addition, the staff of the STD actively participated in the public awareness programme of the CBSL functioning as resource persons for training programmes and seminars during the year. Many officers participated in both local and foreign training programmes, workshops and seminars to further their knowledge and skills during the year enabling them to improve the quality and productivity of the department.

### 25.1 Statistical surveys

The Monthly Inflation Expectation Survey which was initiated in end 2006 was continued. It covered a sample of around 300 respondents and their responses were collected through different means such as telephone interviews, work-site interviews and e-mails. The results of each month's survey were submitted to the Monetary Policy Committee (MPC) and the Monetary Policy Consultative Committee (MPCC) at their monthly meeting in the subsequent month. The land price survey, which was initiated in 2006, too was continued.

In addition, the STD, jointly with Payments and Settlement Department (PSD), conducted a "Customer Survey on adherence to T+1 Cheque Realization Time period" at the request of the PSD of the CBSL. The objective of the survey was to obtain a feedback from banks' current account holders on the adherence of licensed commercial banks to the direction issued by the PSD on 3rd December, 2007 on service norms and standard times for accepting cheques and crediting such proceeds to customer accounts. In addition, it was expected to obtain the information on customers' awareness and satisfaction on the new system and the reasons given by banks for the delay in cheque realization. A sample of 1,200 current account holders from 100 centres were selected covering all districts in the provinces except Northern and Eastern Provinces. From

each centre, a sample of 12 current account holders was interviewed.

Preliminary work for the proposed Consumer Finances and Socio Economic Survey 2011/12 was also commenced during the year. The other major task completed during the year was the compilation of a revised Prosperity Index to measure prosperity in Sri Lanka and the provinces.

### 25.2 National and provincial income statistics

The process of monitoring the developments in the real sector of the economy and forecasting national income continued during 2009. This included collection of primary and secondary data, analysis of developments and forecasting future trends in production, consumption, savings and investments in the country.

The sole responsibility of compilation and dissemination of national income estimates is with the Department of Census and Statistics (DCS) which is the national statistical bureau of the country. However, the STD continued to compile and publish provincial Gross Domestic Product (GDP) statistics, based on the disaggregation of the (GDP) compiled by the DCS.

### 25.3 Country wide data collection system

The Country Wide Data Collection System (CWDCS), which commenced in 1978, completed 31 years of operation in 2009. It continued during the year with regular collection of information on retail prices of consumer goods, producer prices of agricultural commodities and the informal sector wage rates. Collection of data was accomplished through an island-wide network of government school teachers, who functioned as statistical investigators for 101 data collection centres operated in the island, including 18 centres from the North and East. Data collected under the system is extensively used for compilation of price indices, projections of the price movements for policy decisions, evaluation of the impact of policy changes on prices and estimation of national expenditure and income. Data were also useful for analysing seasonal variations, volatility and regional differences in prices and wages. The sub-sectors covered for collection of wage information under the scheme included paddy, tea, rubber and coconut cultivation, small-scale construction and services.

A new set of data collection formats of the CWDCS was designed taking into account current developments in markets in the areas of product differentiation, withdrawal of existing products and trade names from the market and emerging of new products/economic activities. The accuracy of data collection was ensured through regular field supervision of centres according to a pre-set time table at the beginning of the year. As in the past, four regional seminars were conducted in Colombo, Matara, Anuradhapura and Kandy in 2009 in order to provide refresher training to the investigators in order to improve

the accuracy, quality, efficiency and timeliness of their data collection and to obtain feedback on differences in price developments across regions identified in the computation of the provincial price indices. At these programmes, special assessments were conducted on contemporary developments in economic activities and the impact of macroeconomic policies.

Preliminary work was undertaken by the STD at the end of the year to conduct a special symposium for all teacher investigators across the country, to place on record the appreciations of the valuable services rendered by them and review the progress of the CWDCS. The seminar and award presentation for teachers who have completed 5 years of service in the CWDCS was successfully concluded on 09 January 2010, at the Centre for Banking Studies, Rajagiriya.

#### 25.4 Prices, wages, employment and productivity

The STD continued with regular and close monitoring of the movements of consumer prices based on the Colombo Consumers' Price Index (CCPI) compiled by the DCS and issuing monthly press releases analyzing price developments. Analytical reports on price developments for policy makers to facilitate macroeconomic management also continued to be prepared by the STD. Projections for short-term and medium term inflation were prepared by the STD to be used as leading indicators of the future direction of price movements. During the year, the STD had a continuous dialogue with the DCS to discuss the progress and issues of the proposed scheme for re-basing the CCPI based on the consumer expenditure pattern as reflected by the latest Household Income and Expenditure Survey conducted in 2006/07 by the DCS.

In addition to the foregoing, provincial Consumer Price Indices (CPI) and a composite CPI covering the entire country were also compiled and analysed by the STD, with a view to meeting the need of policy makers under a decentralized administration. The STD continued to compile these provincial CPIs based on the latest Consumer Finances and Socio Economic Survey (CFS) of 2003/04. The prices necessary for the compilation of these indices were either collected through the CWDCS or by outsourced investigators who had been trained and are closely supervised by the STD. Meanwhile, the STD continued with compiling the Wholesale Price Index to analyse movements in producer or wholesale prices at the primary market level.

The STD also compiled an Informal Sector Wage Rate Index (ISWRI) for Sri Lanka, based on the wage data collected under the CWDCS.

The Annual and Quarterly Public Sector Employment Surveys (QPSES) were also carried out by the STD to be used in the compilation of national income estimates

and for finding the levels and trends of public sector employment in the country. The information collected in these surveys can be used to assess the effectiveness of the current employment policy of the government and as a measure of improving productivity and efficiency in the public sector. Information collected on labour force and labour market was also analysed by the STD covering the areas of foreign employment, labour relations and labour market reforms, and labour productivity.

#### 25.5 Dissemination of statistics

The STD released its annual publications titled "Economic and Social Statistics of Sri Lanka 2009 – Volume XXXI" and "Sri Lanka Socio Economic Data 2009 – Volume XXXII" in April and June 2009 respectively. In addition, the statistical tables in the pocket diary 2010 of the CBSL were also updated.

### 26. SUPERVISION OF NON-BANK FINANCIAL INSTITUTIONS

The Department of Supervision of Non-Bank Financial Institutions (SNBFI Dept.) was established, as per the Monetary Board decision at its meeting held on 12.12.1988, to regulate and supervise finance companies. It was assigned the responsibility of enforcement of the provisions of the Finance Companies Act No. 78 of 1988 (FCA) involving mainly regulation and supervision of finance companies registered under the FCA and action relating to unauthorised conduct of finance business. In addition, SNBFI Dept. has been vested with the responsibility of implementation of the Finance Leasing Act No.56 of 2000 (FLA), which provides for the regulation and monitoring of finance leasing business. Further, since 2006, the task of establishing a regulatory and supervisory mechanism for the micro finance sector in the country was also vested by the Monetary Board in the SNBFI Dept. The names of registered finance companies (RFCs) and registered finance leasing establishments (RFLEs) as at 31.12.2009 are listed in Annex II-2.

The failure of some institutions that had been raising funds from the public without proper authority caused erosion of public confidence on RFCs and Specialised Leasing Companies (SLCs) causing severe liquidity constraints and performance difficulties in some RFCs and SLCs during the year 2009 and it posed new challenges to the SNBFI Dept. to maintain the stability of those sectors.

The SNBFI Dept. continued to improve its regulatory and supervisory functions through off-site surveillance and on-site examinations. It took actions to issue new directions and to amend the existing directions in addition to taking actions to address liquidity constraints which include the introduction of a government stimulus package for the finance and leasing sectors and a Central Bank Credit Guarantee Scheme in respect of bank loan facilities to

RFCs and SLCs. Further, action was taken to enhance awareness of major stakeholders of the RFC and SLC sectors on major statutory and regulatory requirements and prudential conduct of finance and leasing businesses. The SNBFI Dept. had to play a vital role to facilitate courts on several cases relating to unauthorised finance businesses.

### 26.1 Issue of directions to RFCs

A summary of the new prudential directions, guidelines and the amendments to the existing prudential requirements issued to RFCs in 2009 is given below. These directions and guidelines are contained in Part III of this Report.

#### i. **Direction on Corporate Governance was issued to RFCs in 2008, with effect from 1<sup>st</sup> January 2009**

The main purpose of the direction is to make the board of directors more responsible and accountable for affairs of the respective finance company to promote a healthy and robust risk management framework for finance companies in order to maintain the overall soundness of the RFCs.

#### ii. **Revised direction on liquid assets of RFCs to reduce the required minimum level**

The new direction, which replaced the Finance Companies (Liquid Assets) Direction No. 3 of 2005, reduced the required minimum level of liquid assets that should be maintained against outstanding time and savings deposits liabilities of an RFC from 15 per cent to 10 per cent and 20 per cent to 15 per cent respectively, as a means of addressing liquidity constraints faced by RFCs during the year.

#### iii. **Revised the direction on interest rates that can be paid by RFCs on deposits**

The direction was revised twice during the year. The first revision, which replaced the Finance Companies (Interest) Direction No. 02 of 2008, was to increase the upper limit of the rates of interest that may be paid by RFCs on deposit and discounting rate of bonds or other instruments issued by RFCs, by 2 percentage points with effect from 1<sup>st</sup> April 2009. The second revision effected from 30 September 2009, was the reduction of the premium of interest that RFCs can pay over the weighted average yield applicable to 364 days Treasury bill rate from 4 per cent to 3.5 per cent in respect of deposits having a maturity period of 12 months or less and from 6 per cent to 5.5 per cent for the deposits having a maturity over 12 months. This revision was done having considered the movements of market interest rates.

#### iv. **Certain regulatory requirements in respect of obtaining facilities under the government stimulus package for RFC and SLC sectors**

A new direction was issued as part of the implementation of the government stimulus package for distressed RFCs and SLCs. Accordingly, the RFCs that intend to obtain facilities under the package were required to fulfill certain requirements to improve efficiency, corporate governance and proper utilisation of funds.

#### v. **Issue of a new direction on reporting requirements**

This direction was issued on 30 December 2009 stipulating deadlines for submission of periodic returns by RFCs to the SNBFI Dept.

### 26.2 Licensing of new Finance Companies and Granting Regulatory Approvals

The SNBFI Dept. continued to process applications for new registration, mergers and structural changes of RFCs. During the period under review, one SLC was registered under the FCA. Further, approval was granted to change the name of Silverreen Finance Company Ltd. as People's Merchant Finance Company Limited, Seylan Merchant Leasing PLC as People's Leasing Finance PLC and The Finance & Guarantee Co. Ltd as Island Finance Co. Ltd.

### 26.3 Continuous supervision of RFCs

Continuous off-site surveillance of RFCs was carried out by analyzing the information received through periodic returns submitted by the RFCs through the on-line reporting system to ascertain the financial condition of each company and the compliance with the directions issued and rules made by the Monetary Board under the FCA.

### 26.4 Statutory examinations of RFCs

On-site comprehensive examinations were carried out to assess the liquidity, asset quality, capital adequacy, management efficiency, earnings, profitability, systems and controls and the status of corporate governance of RFCs. During 2009, SNBFI Dept. conducted 14 examinations of RFCs. In addition, 17 RFCs that were not subject to comprehensive examinations during the year were examined on a limited-scope to assess liquidity, credit administration, asset portfolio, capital adequacy and systems and controls. The findings of both comprehensive and limited-scope examinations were communicated to the Board of Directors and senior management of the respective RFCs and they were directed to take urgent corrective action regarding deficiencies, i.e., non-compliance with the prudential requirements, transfers of funds, earnings, payment of commission/incentives and corporate governance issues. The board of directors of the respective RFC was required to give firm commitments with specific time frames for correcting the regulatory concerns.

### **26.5 Monitoring of registered finance leasing establishments**

The total number of registered finance leasing establishments stood at 74 at the end of 2009, consisting of 19 licensed banks, 34 RFCs and 21 SLCs. During the year, registration of three licensed commercial banks and one licensed specialised bank was cancelled, due to their failure to commence finance leasing business within twelve months of registration under the FLA.

### **26.6 Issue of directions to SLCs**

During the year, the Director of SNBFI Dept. in terms of the FLA, issued directions to SLCs on the following aspects. The details of these directions are contained in Part III of this Report.

#### **i. Introduced certain regulatory requirements in respect of obtaining facilities under the government stimulus package for SLCs**

A new direction was issued as part of the implementation of the government stimulus package for distressed RFCs and SLCs. In terms of the direction, the SLCs that intended to obtain facilities under the package were required to fulfill certain requirements intended to improve efficiency, corporate governance and proper utilisation of funds.

#### **ii. Limits on accommodations granted by SLCs**

The direction stipulated certain restrictions on accommodations that could be granted by an SLC to related parties of an SLC and against its shares or shares of its subsidiary companies to purchase shares and on the guarantee or indemnity of a director or any employee of the SLC.

#### **iii. Restrictions on business transactions with directors of SLCs**

The direction stipulated certain restrictions on the business transactions directors of an SLC or their relatives could have with the respective SLC.

#### **iv. Corporate governance**

The direction issued in line with the directions on corporate governance issued to licensed banks and RFCs. The direction was effective from 01 January, 2010. The main aspects of the direction are the responsibilities of the board of directors, composition of the board of directors, criteria to assess the fitness and propriety of directors, management functions delegated by the board, separation of duties of the chairman and the chief executive officer, board appointed committees and disclosure of financial statements. A number of transitional provisions on several key aspects of the direction were provided to

facilitate a smooth transition to the new requirements. The main purpose of the direction was to make boards of directors more responsible and accountable for affairs of the companies to promote a healthy and robust risk management framework.

### **26.7 Examinations of SLCs**

During the year 2009, the SNBFI Dept. continued its off-site surveillance of SLCs on a monthly basis. In addition, six on-site comprehensive examinations and three limited-scope examinations were conducted. On-site comprehensive examinations were conducted to appraise the financial performance, the risks that a particular SLC was exposed and to evaluate the effectiveness of the systems and controls in place. On-site limited-scope examinations were conducted taking into account specifically identified areas of operations. These examinations were also used to ascertain the accuracy of the financial reporting and to check the compliance with the directions by the SLCs.

### **26.8 Failed finance companies**

The administration and management of nine failed finance companies had been vested in the Monetary Board since 1988 under the provisions of the FCA. Two other companies were under liquidation consequent to filing court action by some creditors of those companies. Subsequently, liquidators were appointed for the companies vested in the Monetary Board as well. Of those 11 companies under liquidation, five companies were wound up by end 2009. The liquidation process of six companies continued during the year. The CBSL was able to collect around Rs. 41.1 mn in 2009 from the failed finance companies in respect of refinance loans granted to those companies. The reports prepared by legal firms and audit firms appointed by the CBSL in respect of improper practices of the failed finance companies, were forwarded to the Attorney General's Department to initiate legal action against directors of those companies.

### **26.9 Action on unauthorised conduct of finance business**

The SNBFI Dept. continued its investigations of persons alleged to carry on finance business without authority. The Monetary Board, in late 2008, determined that some persons had carried on finance business without authority and directed the SNBFI Dept. to take action in terms of the provisions of the FCA. These persons were given a specified period of time to comply with the requirements of the FCA and to apply for registration. However, as they failed to comply with the directions within the stipulated period, necessary regulatory actions were taken under the FCA.

The SNBFI Dept. received complaints regarding 65 persons during the year 2009 and the Department had commenced examinations of such persons under the Section 11 of the FCA.



In addition, the SNBFIDept. replied to approximately 850 customer inquiries/complaints during 2009. In the meantime, some depositors/investors of certain institutions, which collected public funds in various manners and defaulted repayment to the investors filed fundamental rights applications in the Supreme Court. The Supreme Court ordered the Monetary Board to take various actions to safeguard the interests of such investors.

#### 26.10 Assistance to Court

##### i. Action relating to The Golden Key Credit Card Company Ltd

In late 2008, The Golden Key Credit Card Company Ltd (GKCL) faced with financial difficulties and some of the credit card holders who had made security deposits against their credit cards filed fundamental rights applications in the Supreme Court. Having considered those applications on 18.05.2009, the Supreme Court appointed a three member Committee of Chartered Accountants to examine the assets and liabilities of GKCL and to prepare a scheme of disbursement for the investors/depositors. In terms of the initial report submitted by the Committee on 01.06.2009, the Supreme Court directed to set up a secretariat with a Chief Operating Officer and a Competent Secretary within the CBSL, to facilitate the functions of the Committee. Accordingly, a secretariat was established within the SNBFI Dept. in June 2009 and the SNBFIDept. facilitated the Committee on the process of taking actions required to implement orders of the Supreme Court. The Committee conducted 51 meetings during the year with the officials of the GKCL and other related companies of the Ceylinco Group, and discussed the means to implement a repayment plan in conformity with the orders of the Supreme Court. Further, the Committee took action to conduct an investigative audit of GKCL by an audit firm and appointed an audit firm as a financial consultant to advise the Committee on creation of a Special Purpose Vehicle to which the shares, investments and shareholdings of the respective companies should be transferred as a measure of implementing the repayment plan. During the year, funds amounting to Rs. 663 million were collected from cash balances available in bank accounts of some persons responsible for operations of GKCL and action was taken in relation to recovery of assets belong to the GKCL and related companies.

The Committee recommended a part repayment of dues to 2,493 cardholders of the total of 3,863 cardholders whose security deposits were Rs. 1 million or below. The part repayment was made on the basis of either 75 per cent of the deposit balance

as at 31.12.2008 or Rs.100,000/- whichever is lower. Accordingly, Rs. 241.4 million was repaid during the year. At the end of the year, work was in progress to make payments on the same basis to other investors/depositors of GKCL.

##### ii. Action relating to other companies

The SNBFIDept. also assisted the court proceedings instituted by the Criminal Investigations Department based on complaints made by some customers of Ceylinco Shriram Capital Management Services Company (Private) Limited, Ceylinco Capital Investment Company (Private) Limited and CLC Asset Management (Private) Limited, by evaluating the repayment plan submitted by such companies to the Magistrate's Court, Colombo Fort. Further, the SNBFIDept. assisted the court proceedings in respect of Finance & Guarantee Property Developers (Pvt) Ltd and F & G Real Estate Company Ltd; by giving evaluations and observations on the proposed trust arrangement for the repayment of depositors of those companies.

#### 26.11 Proposed Major Revisions in the Draft Act to Combat Unauthorised Finance Business

In order to strengthen the provisions to combat the carrying of finance business and accepting deposits without authority, several measures were proposed in the draft Act to be brought repealing and replacing the FCA. Major revisions proposed in the draft Act to curb unauthorised finance business/accepting deposits without authority are as follows;

- i Acceptance of deposits without authority is made an offence
- ii. Definition of "deposit" is introduced
- iii. Investigative powers are enhanced
- iv. Enhanced the powers to curb unauthorised finance business/acceptance of deposits which include powers to obtain a court order to;
  - a. Compel a person to provide information and books relating to illegal deposit taking institutions/ persons,
  - b. Freeze assets of persons carrying on finance business/accepting deposits without authority,
  - c. Impound passports of persons carrying on finance business/accepting deposits without authority,
  - d. Call information regarding the assets and liabilities of the directors of institutions carrying on finance business/accepting deposits without authority,

**Registered Finance Companies and Registered Finance Leasing Establishments  
(as at end 2009)**

| Companies registered under the Finance Companies Act   | Institutions registered under the Finance Leasing Act  |
|--|--|
| <p><b>Registered Finance Companies</b></p> <ol style="list-style-type: none"> <li>1. Abans Financial Services Ltd.</li> <li>2. Alliance Finance Company PLC.</li> <li>3. AMW Capital Leasing Ltd.</li> <li>4. Arpico Finance Company PLC.</li> <li>5. Asia Assets Finance Ltd.</li> <li>6. Asian Finance Ltd.</li> <li>7. Associated Motor Finance Company Ltd.</li> <li>8. Bartleet Finance Ltd.</li> <li>9. Bimputh Lanka Investments Ltd.</li> <li>10. Capital Reach Leasing PLC.</li> <li>11. Central Finance Company PLC.</li> <li>12. Central Investments &amp; Finance Ltd.</li> <li>13. Ceylinco Investments &amp; Realty Ltd.</li> <li>14. Chilaw Finance Ltd.</li> <li>15. Citizens Development Business Finance Ltd</li> <li>16. Commercial Credit Ltd.</li> <li>17. Edirisinghe Trust Investments Ltd.</li> <li>18. Industrial Finance Ltd.</li> <li>19. Lanka ORIX Finance Company Ltd.</li> <li>20. LB Finance PLC.</li> <li>21. Mercantile Investments Ltd.</li> <li>22. Merchant Credit of Sri Lanka Ltd.</li> <li>23. Nanda Investments Ltd.</li> <li>24. Nextfinance Ltd.</li> <li>25. People's Leasing Finance PLC<br/>(formerly Seylan Merchant Leasing PLC)</li> <li>26. People's Merchant Finance Company Ltd.<br/>(formerly Silverreen Finance Co. Ltd)</li> <li>27. Senkadagala Finance Company Ltd.</li> <li>28. Singer Finance (Lanka) Ltd.</li> <li>29. Sinhaphuthra Finance Ltd.</li> <li>30. Swarnamahahal Financial Services Ltd.</li> <li>31. Island Finance Company Ltd.<br/>(formerly The Finance &amp; Guarantee Company Ltd.)</li> <li>32. The Finance Company PLC.</li> <li>33. The Multi Finance Company Ltd.</li> <li>34. Trade Finance &amp; Investments Ltd.</li> <li>35. Vallibel Finance Ltd.</li> </ol> | <p><b>Registered Finance Leasing Establishments</b></p> <p><b>(A) Licensed Commercial Banks</b></p> <ol style="list-style-type: none"> <li>1. MCB Bank Ltd</li> <li>2. Commercial Bank of Ceylon PLC</li> <li>3. National Development Bank PLC</li> <li>4. Nations Trust Bank PLC</li> <li>5. Pan Asia Banking Corporation PLC</li> <li>6. People's Bank</li> <li>7. Union Bank of Colombo Ltd</li> <li>8. Bank of Ceylon</li> <li>9. Sampath Bank PLC</li> <li>10. Seylan Bank PLC</li> <li>11. Hatton National Bank PLC</li> </ol> <p><b>(B) Licensed Specialised Banks</b></p> <ol style="list-style-type: none"> <li>1. MBSL Savings Bank Ltd</li> <li>2. DFCC Bank</li> <li>3. Rajarata Development Bank</li> <li>4. Ruhuna Development Bank</li> <li>5. Wayamba Development Bank</li> <li>6. Sanasa Development Bank Ltd</li> <li>7. Sabaragamuwa Development Bank</li> <li>8. Lankaputhra Development Bank Ltd</li> </ol> <p><b>(C) All Registered Finance Companies listed above except Bimputh Lanka Investments Ltd.</b></p> <p><b>(D) Specialised Leasing Companies (SLCs)</b></p> <ol style="list-style-type: none"> <li>1. Asia Commerce Ltd.</li> <li>2. Assetline Leasing Company Ltd.</li> <li>3. Capital Reach Credit Ltd.</li> <li>4. Ceylease Financial Services Ltd.</li> <li>5. Ceylinco Leasing Corporation Ltd.</li> <li>6. Commercial Leasing Company Ltd.</li> <li>7. Co-operative Leasing Company Ltd.</li> <li>8. Indra Finance Ltd.</li> <li>9. Isuru Finance Company Ltd.</li> <li>10. Kalutota Investments &amp; Leasing Ltd.</li> <li>11. Koshiba Leasing Company Ltd.</li> <li>12. Lanka ORIX Leasing Company PLC.</li> <li>13. Lisvin Investments Ltd.</li> <li>14. LOLC Micro Credit Ltd.</li> <li>15. Merchant Bank of Sri Lanka PLC.</li> <li>16. Nation Lanka Finance PLC<br/>(formerly Ceylinco Finance PLC)</li> <li>17. Orient Financial Services Corporation Ltd.</li> <li>18. People's Leasing Company Ltd.</li> <li>19. People's Merchant Bank PLC.</li> <li>20. Sampath Leasing &amp; Factoring Ltd.</li> <li>21. Seylan Merchant Bank PLC.</li> </ol> |

e. Police and Divisional Secretaries to provide information on persons carrying on finance business/ accepting deposits without authority, if the Director of SNBFI Dept. so requires them,

f. Advertising soliciting deposits without authority/ publication of advertisements soliciting deposits without authority are made offences.

v. Restriction/prohibition of the use of words 'finance', 'financing' and 'financial' in a name or description of an entity is restricted and use of an abbreviated name or acronym of a licensed finance company by any other company is prohibited.

vi. Penalties are enhanced and abetting to commit an offence is also made an offence under the draft Act.

Further, carrying on finance business and accepting deposits without authority are made indictable offences by the Attorney General in the High Court.

### 26.12 Public awareness programmes

The SNBFIDept. continued to educate the general public on matters relating to the unauthorised conduct of finance business as follows;

- i. Publication of press notices with an explanatory note providing the definition of deposits, categories of institutions/organisations authorised to carry on finance business including acceptance of deposits under different laws and a list of institutions authorised by the CBSL to carry on finance business.
- ii. Distribution of a leaflet titled “Mobilisation of Funds from the Public by Unauthorised Persons & Institutions” among the public through various means.
- iii. Establishment of a call centre in the CBSL to facilitate the public to obtain information relating to financial institutions and to make complaints regarding such institutions.
- iv. Conducted ten awareness programmes, presentations, opening counters at public exhibitions, etc.

### 26.13 Establishment of a Mechanism to Regulate Micro Finance Institutions

The micro finance institutions (MFIs) are not regulated or monitored through a specific regulatory and supervisory authority or arrangement, at present. In view of the importance, diversity and complexity of the micro finance sector, the Monetary Board recommended the setting up of an Independent Authority for regulation and supervision of MFIs in the country. SNBFI Dept. attended to formulate a regulatory and supervisory regime for this sector under the provision of a separate legislation.

## 27. WELFARE

In 2009, the Welfare Department (WD) continued to provide welfare facilities to the employees, pensioners and their registered dependents totalling to more than 10,000 in an efficient manner. The facilities provided included

medical benefits, in-house health clinic, concessionary loan facilities, restaurant services and other ancillary facilities. In 2009, the WD, on behalf of the employees, obtained a group insurance policy Cover for CBSL employees to cover injuries and death, other than from natural causes sustained by them during off duty hours.

Having considered the real estate market prices and increase in the cost of construction of houses, the quantum of loan granted for housing was increased. Accordingly, amounts granted for repairs and extensions for the existing house were also increased.

Steps were taken to increase the amount granted for vehicle loans and also simplified the eligibility criteria for grant of vehicle loans in 2009. The total number of housing loans granted was 78 while total number of vehicle loans granted was 37. In addition to these two types of loans, other staff benefit loans granted under the Provident Fund cover was 932 including staff benefit loans, computer loans and medical loans etc. The WD continued to ensure disbursement of loans efficiently by releasing the loans within a short period of time. Arrangements were made to recover housing loans in full from pensioners who have completed 70 years of age and to release their house property deeds. A survey conducted by the WD revealed that beneficiaries were very much satisfied with the services provided by the WD.

Regarding other ancillary services, the system of granting of railway warrants was automated. Demand for railway warrants has increased due to new recruitments and improved security situation in the country after the end of war. Total number of warrants issued increased significantly from 444 in 2008 to 850 in 2009.

The WD made every effort to provide a healthy and a palatable meal to the staff by improving the restaurant services. In addition to the restaurant service of providing breakfast, lunch and tea to the staff, the WD met all the requests pertaining to catering made by other departments for their day to day meetings and special occasions to their best satisfaction.

Courtesy visits of bomb victims were made and facilities provided for blind bomb victims were increased by way of increasing their monthly payment made for transport and telephone facilities etc. Conducting of lectures during the lunch break on important topics relevant to health and well being for the benefit of the staff was continued.